IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No.

V. F. BOND, ET AL., *Petitioners*

v.

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Perpetual Building Association, Samuel Scrivener, Jr., Trustee and Junior F. Crowell, Trustee, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The memorandum opinion of the United States District Court for the Eastern District of Virginia, Alexandria Division (App., *infra*, p. 1a), is reported at 172 F. Supp. 759. The unreported memorandum opinion of the United States District Court for the Eastern

District of Virginia, Alexandria Division, is printed, App., *infra*, p. 6a. The unreported opinion of the United States Court of Appeals for the Fourth Circuit is printed, App., *infra*, p. 8a. The unreported dissenting opinion of the United States Court of Appeals for the Fourth Circuit is printed, App., infra, p. 27a.

JURISDICTION

The decree of the United States Court of Appeals for the Fourth Circuit was entered on May 31, 1960. The jurisdiction of this court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether the priority of a mortgagee over a subsequent federal tax lien extends to sums paid by the mortgagee pursuant to the mortgage for real estate taxes accruing after the federal tax lien arises.

2. Whether the priority of a mortgagee over a subsequent federal tax lien extends to sums paid by the mortgagee after the federal tax lien arises and pursuant to the mortgage for attorneys fees to establish the priority of the mortgagee over the federal tax lien for sums paid by the mortgagee for local real estate taxes.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all prop-

erty and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1958 ed., Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1958 ed., Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) Invalidity of Lien Without Notice.—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) Under state or territorial laws.—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) With clerk of district court.—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) With clerk of district court for District of Columbia.—In the office of the clerk of the United States District Court for the District of

Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) Form of Notice.—If the notice filed pursuant to subsection (a)(1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) Exception in Case of Securities.—

* * * * * *

(26 U.S.C. 1958 ed., Sec. 6323.)

Revised Statutes:

SEC. 3466. Whenever any person indebted to the United States is insolvent or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be the first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

(31 U.S.C. 1958 ed., Sec. 191)

STATEMENT

This action was commenced by a complaint (R. 3-15) filed by the United States on October 29, 1957 in the United States District Court for the Eastern District of Virginia, Alexandria Division, for the foreclosure of federal tax liens upon the property and rights to property of taxpayers V. F. Bond and Audrey A.

Bond. The complaint was filed pursuant to Sections 7401, 7402(a) and 7403, Internal Revenue Code of 1954 and Section 1345 of Title 28, U.S.C. (R. 3). The complaint alleged that there were assessed against taxpayers on December 20, 1955, deficiencies for the years 1943 through 1947, totaling $318,832.84 and against taxpayer V. F. Bond, on the same date, deficiencies for the year 1942 in the amount of $18,306.16 (R. 7, 8). The complaint further alleged that on or about December 20, 1955 notice of each of the assessments was served on taxpayers and demand for payment made and that taxpayers have refused to pay the amount assessed; it was further alleged that on December 21, 1955 notice of each of the described assessments was filed in the Office of the Clerk of the Circuit Court of Arlington County, Virginia, and other appropriate places. It was alleged that on July 2, 1957 the aforesaid assessments were reduced to judgment at which time the United States District Court for the Eastern District of Virginia found that there was due to the United States as of July 31, 1957 the sum of $343,318.45, plus interest, for the years 1943 through 1947 and $14,164.73, plus interest, for the year 1942 (R. 8, 9).

The complaint listed various items of real and personal property owned by taxpayers and named as defendants the parties having an interest in such property, including petitioners Perpetual Building Association, hereinafter called "Perpetual", Samuel Scrivener, Jr., Trustee and Junior F. Crowell, Trustee (R. 3). The complaint prayed for the appointment of a receiver to enforce the liens of the United States against the properties of taxpayers, that the liens against the various properties be determined and that

the liens of the United States should be foreclosed by a sale of the properties involved and the proceeds distributed in accordance with the findings of the Court (R. 14). After hearing, the District Court, on November 27, 1957, found that the United States had valid tax liens in the principal sum of $357,484.18, plus interest, and that taxpayers were insolvent. A custodial receiver and special master were appointed (R. 17-22). On September 24, 1958 the District Court entered an order confirming the sale of the Arlington Hotel for $172,500.00 (R. 41-43).

1. The pertinent facts may be summarized as follows:

Petitioners Samuel Scrivener, Jr., Trustee and Junior F. Crowell, Trustee, are Trustees under a mortgage[1] given by taxpayers on certain real estate in Arlington, Virginia, referred to in the record as the Arlington Hotel. This mortgage, dated July 13, 1955 and recorded July 15, 1955, secures payment of $100,000.00 to the treasurer of Perpetual (R. 30). Monthly payments were made on this mortgage until October 4, 1956, after which no further payments were made to Perpetual (R. 16). The monthly payments under the mortgage included $331.00 for local real estate taxes. The entire monthly payment was credited by Perpetual on the principal balance and then the amount of the local real estate taxes was charged against said balance when paid on behalf of taxpayers by Perpetual (R. 46, 47). The following are among the covenants of the mortgage:

[1] The instrument in question was actually a deed of trust, but there is no dispute that it qualified as a "mortgage" within the meaning of 26 U.S.C.A. § 6323(a), *supra*.

IT IS HEREBY COVENANTED:

* * * * *

(2) that any and all taxes and assessments, general or special, now or hereafter assessed against said realty shall be paid when due.

* * * * *

(7) that the title to said realty and the record of said title shall be kept free of litigation, infirmity and lien,

* * * * *

(10) that any and all disbursements made by the Treasurer because of the failure of the grantor to make any payment or do any act required to be made or done, with interest thereon at six per cent (6%) per annum, shall be demandable at any time by the Treasurer and until paid to the Treasurer shall be deemed to be secured by this deed of trust, and

(11) that if there shall be any default in the performance of any of the foregoing covenants, the Treasurer shall have the right and power to do any one or more of the following:

(a) do any act or make any disbursement, in his name or the name of the grantor, which he may deem necessary or proper to protect the lien of this Deed of Trust.

On August 7, 1956, August 6, 1957 and August 11, 1958, Perpetual paid local real estate taxes on the Arlington Hotel. The taxes for the year 1956 and a portion of said taxes for 1957 were paid with funds paid to Perpetual by taxpayers for that purpose. Perpetual paid $4,759.16 toward the 1957 taxes and all of the 1958 taxes in the sum of $4,787.16 with its own funds, taxpayers having made no payments on the mortgage with which to pay these taxes (R. 45-52).

Perpetual contends that, having paid the 1957 and 1958 real estate taxes pursuant to authority of the covenants of the mortgage, *supra*, it has a lien for the sums so paid superior to the federal tax lien; further, and also as a consequence of the covenants of the mortgage cited, *supra*, Perpetual contends that it has a lien for attorneys fees incurred in this litigation (the sum of $1,000.00 was allowed by the District Court, App., *infra*, p. 7a) in protecting the lien of its mortgage and that this lien for attorneys fees is also superior to the federal tax lien (R. 16, 17, 26).

The report of the special master gave priority to Perpetual for attorneys fees and other charges called for under the terms of the mortgage (R. 26). The United States took exceptions to the special master's report in this regard (R. 32, 33). The District Court ordered the sale of the Arlington Hotel subject to the liens thereon as found by the special master and reserved decision on questions of priority of lien raised by the exceptions of the United States to the special master's report (R. 37-39). The question of whether the lien of Perpetual for local real estate taxes paid by Perpetual after the filing of the federal tax lien was superior to the federal tax lien arose after sale of the Arlington Hotel and is first reflected in the record in the order of the District Court of January 1, 1959 by reservation of decision thereon (R. 43).

2. In determining the priorities of the various liens asserted against the proceeds of sale of the Arlington Hotel, the United States District Court held:

1. That the priority accorded Perpetual over the federal tax lien by virtue of Section 6323(a), I.R.C., 1954, extends to sums paid by Perpetual for local real estate

taxes for 1957 and 1958, the obligation of the mortgagor-taxpayer to pay these sums being secured by the mortgage to the same extent as the obligation to pay the principal, App., *infra*, p. 1a.

2. That the priority accorded Perpetual over the federal tax lien by virtue of Section 6323(a), I.R.C., 1954, extends to sums paid by Perpetual for attorneys fees to establish the priority of Perpetual for sums paid by Perpetual for local real estate taxes, the obligation of the mortgagor-taxpayer to pay these sums being secured by the mortgage to the same extent as the obligation to pay the principal, App., *infra*, p. 6a.

The United States Court of Appeals for the Fourth Circuit reversed the decision of the District Court and held that the federal tax lien is entitled to priority over the mortgagee for 1957 and 1958 real estate taxes and for the attorneys fees because the claim of the mortgagee for these items was deemed to be inchoate at the time the federal tax lien arose, App., *infra*, p. 8a.

SUMMARY OF ARGUMENT

The choate lien test does not defeat the right of Perpetual to priority for sums paid for taxes and attorneys fees because this priority is compelled by the nature of a mortgage and also by the necessary implications of Section 6323(a), I.R.C., 1954, *supra*, pp. 3, 4. This Court has never applied the choate lien test, developed to defeat state-created liens competing with the federal tax lien where the taxpayer is insolvent, to the interest of a mortgagee. The question of the extent of the priority accorded to mortgagees by Section 6323(a) has never been passed upon by this Court.

In *United States* v. *New Britain*, 347 U.S. 81, the question of the right of the mortgagee to pay local real

estate taxes accruing subsequent to the federal tax lien and to have priority under Section 6323(a) over the federal tax lien for sums so paid was raised but not decided. That question is squarely raised in the case at bar.

Although the District Court below determined that the mortgagors-taxpayers here were insolvent, priority for the United States was not there asserted on the basis of Section 3466 of the Revised Statutes, *supra*, p. 4. See footnote to the opinion of the District Court, App., *infra*, pp. 1a, 2a. The Court of Appeals, App., *infra*, pp. 13a, 14a, held that the United States was foreclosed, as a consequence, from asserting priority under Section 3466 for the first time in the Court of Appeals.

The history of the choate lien test as developed to implement the purpose of Section 3466 of the Revised Statutes reveals that, while having never had occasion to pass on the question, this Court has stated several times that the priority of debts due the United States in insolvency would not affect an antecedent mortgage. A mortgage is more than a lien and constitutes the creation of an estate in the mortgagee and the divesting of an estate out of the mortgagor. A federal tax lien arising after a mortgage of property by the taxpayer can only attach to the property interest of the taxpayer in the mortgaged property, to-wit: the equity of redemption of the mortgagor-taxpayer. The extent of this equity of redemption is determined by the provisions of the mortgage.

Although Section 6323(a) is merely a recording statute, its effect is to accord priority to a mortgagee antecedent to the filing of the notice of the federal tax lien. The extent of the priority thus accorded the mortgagee

is measured by all the covenants of the mortgage and extends to sums paid under authority of the mortgage for taxes and attorneys fees after the filing of the federal tax lien. There being no exception of insolvency in the statute, the priority accorded the mortgagee by Section 6323(a) applies where the mortgagor-taxpayer is insolvent. Congress, in enacting Section 6323(a), intended that the priority provided should extend to expenditures to preserve the security of the mortgagee.

The mortgage of Perpetual being first in time is first in right. From its execution a mortgage is choate and perfected securing the performance by the mortgagor of all covenants therein. It is the priority of Perpetual over the United States which is in issue here, not the priority of the local taxing authority over the United States. The decision of this Court in *United States* v. *R. F. Ball Constr. Co.*, 355 U.S. 587, the only case before this Court in which a contractual lien (an assignment, not a mortgage)—as distinguished from a state-created lien—was competing with the federal tax lien, is not applicable here. The claim of Perpetual to priority is based on an instrument conceded to be a mortgage. Since the claim of Perpetual is based on a mortgage, priority should be accorded to Perpetual for its payments for taxes and attorneys fees under the reasoning of the minority in *United States* v. *R. F. Ball Constr. Co.*, *supra*.

ARGUMENT

The petition for a writ of certiorari should be granted because the question of federal law presented is of continuing importance, has never been passed upon by this court, and was decided wrongly below by the Court of Appeals. The question presented is

whether the priority of a mortgagee over a subsequent federal tax lien extends to sum paid by the mortgagee for local real estate taxes and attorneys fees accruing after the federal tax lien arose. The decision depends on whether the choate lien test developed by this court in preserving the priority accorded by Congress to debts due the United States where the debtor is insolvent is properly applicable to defeat the priority accorded a mortgagee by Section 6323(a), I.R.C., 1954, *supra*, p. 3.

The District Court held that Section 6323(a), *supra*, protects a mortgagee prior in time to a federal tax lien in paying local real estate taxes on the mortgaged property arising subsequent to the tax lien and further protects such a mortgagee to the extent of attorneys fees incurred in defending the priority of the mortgagee. The Court of Appeals reversed the District Court and gave the federal tax lien priority over the lien of the mortgage for local taxes and attorneys fees by applying the choate lien test to the claim of the mortgagee for these items. The Court of Appeals stated, in part, App., *infra*, p. 23a:

> * * * "Therefore, in view of the persistent application of the "choate lien test" by the Supreme Court, which doctrine was recognized and followed by the Ninth Circuit in United States v. Christensen, supra, we reach the conclusion in the instant case that the claimed priority for payment of the real estate taxes accruing after recordation of the federal tax liens, even though made pursuant to an authorized provision of a prior recorded mortgage, must be subordinated to the federal tax lien because such lien so acquired by the mortgagee was unperfected and inchoate at the time the federal tax liens were recorded."

This Court has never held that the choate lien test is applicable to a mortgage. In considering the applicability of the choate lien test to the lien of a mortgage, it appears apposite to consider briefly the genesis of this test and its judicial history to date.

I. HISTORY OF THE CHOATE LIEN TEST

A. The Choate Lien Test as Developed and Applied to Defeat State-Created Liens Where the Debtor of the United States Is Insolvent

Section 3466 of the Revised Statute, supra, p. 4 (hereinafter referred to as "The Insolvency Statute") provides, in substance, that where a debtor of the United States is insolvent, debts due the United States shall be first satisfied. While this statute provides for priority in favor of the United States, it is arguable that a lien should be preferred to a debt due the United States unaccompanied by a lien. This contention was rejected by this court in *Thelusson* v. *Smith*, 15 U.S. (2 Wheat.) 396, the first case construing The Insolvency Statute wherein a judgment creditor claimed priority based on the fact that his judgment constituted a lien. The Court held that to defeat the government's right to priority the judgment lien creditor must have enforced his lien by reducing the property to possession, thus divesting the property interest of the debtor. See *Thelusson* v. *Smith*, 396, 427:

> * * * "Exceptions there must necessarily be as to the funds out of which the United States are to be satisfied, but there can be none in relation to the debts due from a debtor of the United States to individuals. The United States are to be first satisfied; but then, it must be out of the debtor's estate. If, therefore, before the right of preference has accrued to the United States, the debtor has made

a bona fide conveyance of his estate to a third person, or has mortgaged the same to secure a debt, or if his property has been seized under a fi. fa., the property is divested out of the debtor, and cannot be made liable to the United States. A judgment gives to the judgment-creditor a lien on the debtor's lands, and a preference over all subsequent judgment creditors. But the Act of Congress defeats this preference, in favor of the United States, in the cases specified in the 65th Section of the Act of 1799."

It is to be noted that a mortgagee is exempted from the impact of The Insolvency Statute—not only because a mortgage constitutes a choate lien, but also because the estate of the debtor in the property is thereby divested.

In *Conard* v. *Atlantic Ins. Co.*, 26 U.S. (1 Pet.) 386, 441, the contention was that *Thelusson, supra*, had held that only an absolute conveyance was sufficient to defeat the federal priority and thus a mortgage, being merely a lien, should be subordinated to the priority of accorded debts due the United States. This contention was rejected thusly:

> * * * "It is true, that in the discussions in courts of equity, a mortgage is sometimes called a lien for debt and so it certainly is, and something more: it is a transfer of the property itself, as security for the debt. This must be admitted to be true at law: and it is equally true in equity: for in this respect, equity follows the law. It does not consider the estate of the mortgagee as defeated and reduced to a mere lien, but it treats it as a trust estate, and according to the intention of the parties, as a qualified estate, and security. When the debt is discharged, there is a resulting trust for the mortgagor. It is, therefore, only in a loose and general sense, that it is sometimes called a lien, and then only by way of contrast to an estate absolute and

> indefeasible. But it has never yet been decided by this court, that the priority of the United States will divest a specific lien, attached to a thing, whether it be accompanied by possession or not."

In *Brent* v. *Bank of Washington*, 10 Pet. 596, 611, 612, the priority of the mortgagee over the United States in insolvency was reiterated as follows:

> * * * "It has been the uniform construction of this act (the insolvency statute), . . . that whether in a case of insolvency, death or assignment, the property of the debtor passes to the assignee, executor or administrator; the priority of the United States operating, not to prevent the transmission of the property, but giving them a preference in payment out of the proceeds. *Conard* v. *Atl. Ins. Co.*, 1 Peters, 439.
>
> This preference is in the appropriation of the debtor's estate; so that if, before it has attached, the debtor has conveyed or mortgaged his property, or it has been transferred in the ordinary course of business, neither are over-reached by the statutes; 1 Peters, 440; and it has never been decided that it affects any lien, general or specific, existing when the event took place which gave the United States a claim of priority. (Insertion mine)"

In none of the cases cited above has this Court had before it a case where the federal priority was being asserted to defeat a mortgage. For subsequent cases noting in *dicta*, the priority of a mortgage in insolvency because the property mortgaged is, subsequent to the mortgage, no longer a part of the debtor's estate, see *Savings & Loan Society* v. *Multnomah County*, 169 U.S. 421, 428; *United States* v. *Texas*, 314 U.S. 480, 484 and *New York* v. *Maclay*, 288 U.S. 290, 292.

In *Maclay, supra,* the choate lien test got its name through the characterization of a competing state tax lien as inchoate. Certiorari was granted to decide the question of whether or not the federal priority commanded by The Insolvency Statute obtained where the competing claim was a lien as well as a debt. Citing *Thelusson, supra,* the court held that a lien must be so specific as to bring about a change of title or possession. Referring to the line of cases beginning with *Conard, supra,* with regards the position of mortgages in insolvency, the court refused to speculate as to what the rule might be in jurisdictions where a mortgage created only a lien and nothing more. In this regard, however, the court noted, 288 U.S. 290, 292, that "a mortgage, even though a lien is one much more specific than a judgment or a tax, much closer to ownership".

Although this court has not decided a case turning on the point, lower federal courts, following *Conard, supra,* have consistently upheld the priority of mortgages executed by the debtor prior to a determination of insolvency. See *United States* v. *Guaranty Trust Co.*, 33 F. 2d 533, Aff'd. on other grounds, 280 U.S. 478, *Exchange Bank & Trust Co.* v. *Tubbs Mfg. Co.*, 246 F. 2d 141 and *Bank of Wrangell* v. *Alaska Asiatic Lumber Mills*, 84 F. Supp. 1. In *Guaranty Trust, supra,* the competing federal claim was not a federal tax lien. In *Exchange Bank & Trust Co.* and in *Bank of Wrangell,* the competing federal claim was a federal tax lien. In the former case, the court relied on Section 6323(a), *supra,* in preferring the mortgage. In the latter case, no mention was made of 6323(a) and the case seems to have been decided on the basis that the property interest of the debtor had been diminished by

the giving of the mortgage. This was consistent with the line of cases beginning with *Conard, supra.*

Federal tax liens secure "debts due the United States" and following the rationale of *Thelusson*, this court proceeded to develop highly technical tests to be applied to liens competing with the federal tax lien in insolvency cases. The court required that the competing lien be: "specific in amount" (*New York* v. *Maclay, supra*); enforceable without the assistance of the courts (*United States* v. *Texas*, 314 U.S. 480, 488); attached to a specific property (*United States* v. *Waddill; Holland & Flinn*, 323 U.S. 353, 356, 357); and "specific" to the extent that the lien is attached by reducing the property to possession (*United States* v. *Gilbert Associates*, 345 U.S. 361, 366). In all of these cases, the court was concerned with competing statutory liens created by state law.

B. The Choate Lien Test as Applied to Defeat State-Created Liens Where the Debtor of the United States Is Solvent

In *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, this court, for the first time, applied the choate lien test developed in the insolvency cases to the lien of a creditor of a solvent federal tax debtor. Here again, the question of priority arose between the federal tax lien and a state-created lien—an attachment. This court held that when the federal tax lien arose, the attachment was inchoate because it was only a "caveat of a more perfect lien to come".

The validity of the analogy in *Security Trust* to the choate lien test developed in the insolvency cases is questionable. The essential difference between the "pure" lien priority cases and the insolvency cases is that a federal priority is provided by federal statute in

the insolvency cases! No federal priority has ever been legislatively provided in the lien cases. Consequently, the federal tax lien arises under Section 6322 when the federal tax is assessed and competing state-created liens should arise as provided by state law, provided that the federal courts would deal with each state-created lien on its merits and deal with the problem of the relation back of a state-created lien according to the type of lien it was considering in a particular case. If the choate lien test developed in the insolvency cases is to be carried over into the lien priority cases, then, except as Section 6323(a) may be applicable, it is doubtful if any lien, while it still remains a lien, can defeat the federal tax lien in a priority contest.

In *United States* v. *New Britain*, 347 U.S. 81, this Court held, in a conflict of liens between the City of New Britain for real estate taxes and water rents and the federal government's tax liens, that the rule of first in time is first in right should apply—despite the fact that local tax liens were not among the interests mentioned in Section 6323(a). The court accepted the specificity of the local tax liens under state law, even though they had not been enforced by taking possession of or title to the real estate in question.

In the next year, this Court, in three opinions by Mr. Justice Minton, the author of *New Britain*, again applied the choate lien test in non-insolvency cases to defeat three state-created liens. See *United States* v. *Acri*, 348 U.S. 211 (Ohio Attachment Lien); *United States* v. *Liverpool & London Ins. Co.*, 348 U.S. 215 (Texas Garnishment Lien); *United States* v. *Scovil*, 348 U.S. 218 (South Carolina Landlord's Lien). Subsequently, the Court, in four memorandum opinions, held mechanic lien claims subordinate to the federal tax

lien. See *United States* v. *Colotta*, 350 U.S. 808; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010; *United States* v. *Vorreiter*, 355 U.S. 15; United *States* v. *Hulley*, 358 U.S. 66.

On June 20, of this year, this Court handed down two opinions in which a subcontractor was preferred to the federal tax lien on the ground that the property right of the general contractor-taxpayer in the proceeds of the construction contract was reduced under state law by: (1) the right of the subcontractor to create a personal liability on the owner to pay the subcontractor rather than the taxpayer (*United States* v. *Durham Lumber Co.*, October Term 1959, No. 23); (2) the duty of the general contractor to hold the proceeds in trust for the payment of any unpaid subcontractors. (*Aquilino* v. *United States*, October Term 1959, No. 1). In *Aquilino*, the case was sent back to the Court of Appeals of New York with direction that that court determine the validity of the contention that the genera contractor was obligated under New York law to hold the contract proceeds as trust funds. In both of these cases, the Court relied on its previous decisions in *Morgan* v. *Commissioner*, 390 U.S. 78 and *United States* v. *Bess*, 357 U.S. 51 holding that state law determines the property or rights to property to which a federal tax lien attaches.

In *Aquilino* and *Durham Lumber* (hereinafter sometimes referred to as "Durham Lumber"), the taxpayer was the general contractor. In previous mechanic lien cases, the taxpayer had been the owner. Previous lien priority cases involving mechanic's liens in this Court, all *per curiam*, preferred the federal tax lien apparently because the mechanic's lien was inchoate to the

extent that it had not been reduced to final judgment at the time the federal tax lien attached. In *United States* v. *White Bear Brewing Co.*, *supra*, this was the holding despite the fact that a suit to enforce the lien had been filed and the liened property sold in that proceeding prior to the inception of the federal tax lien.

In *Durham Lumber*, this Court holds that because the claim contesting with the federal tax lien on the property of the taxpayer does not, under state law, constitute in form a lien on the property of the taxpayer, such claim is not subject to the choate lien test. It should be noted that in *Durham Lumber* the federal tax lien attached to the property interest of the taxpayer (the chose in action against the owner) prior to action by the subcontractors to perfect any rights they might have under state law to reduce the property interest of the general contractor-taxpayer. It is assumed that under state law the subcontractor was required to file a lien (*Aquilino*) or give notice to the owner (*Durham Lumber*) in order to limit the property interest of the general contractor in the chose in action. Even though the right of the subcontractor is not a lien upon the property of the taxpayer, the effect of the perfection thereof by the subcontractor is to diminish the property interest of the taxpayer subsequent to the effective date of the federal tax lien as against the subcontractor.

The analogy of *Durham Lumber* to the case at bar seems clear. Perpetual under its mortgage (accorded priority over federal tax liens by Section 6323(a), I.R.C., 1954) had a right to be secured for the payment of local real estate taxes paid by it upon default by the mortgagor in his obligation under the mortgage to pay these taxes. The subcontractors in *Durham Lumber*

had a right under state law (previously held by this Court ineffective to defeat the federal tax lien by the imposition of a lien) to reduce the property interest of the taxpayer by perfecting their claims in the event the general contractor-taxpayer failed to pay them as he was obliged to do. Assuming, for purposes of argument, that the lien of Perpetual arose upon payment of the real estate taxes subsequent to the effective date of the federal tax lien against Perpetual, under the holding of *Durham Lumber*, Perpetual should be preferred for these payments. Whereas state law in *Durham Lumber* made the interest of the taxpayer subject to being diminished by action of the subcontractors after the effective date of the tax lien against them, the mortgage had the same effect on the taxpayer in the case at bar.

If the rule be that in *Durham Lumber* the general contractor-taxpayer under state law *never* had a property interest superior to the claim of the subcontractors, the answer in the case at bar is that the mortgagor-taxpayer under the mortgage never had a property interest superior to the claim of Perpetual for reimbursement. This is particularly true when the nature of a mortgage as creating an estate in the mortgagee is invoked.

C. The Choate Lien Test as Applied to Defeat Contractual Liens Other Than Mortgages

In *United States* v. *R. F. Ball Constr. Co.*, 355 U.S. 587, this Court decided *per curiam* the only case to come before it to date where the lien competing with the federal tax lien was a contractual lien as opposed to a state-created lien. There, an assignment by a subcontractor of the proceeds of a construction contract

to his performance bond surety as security for any liability the surety might sustain under its bond for the performance of the contract or on subsequent similar bonds was held to be inchoate and inferior to a federal tax lien arising after the surety has obligated itself on a subsequent bond on the basis of the assignment.

In large measure, it is to resolve in its favor the conflicting opinions as to the implications of the *per curiam* opinion of the majority in *Ball* that Perpetual seeks a writ of certiorari. The Court of Appeals in the case at bar was of the opinion that the majority of this Court in *Ball*, accepting the holding of the lower court that the assignment was in legal effect a mortgage, held that a mortgage is subject to the choate lien test. The dissenting judge in the Court of Appeals was, on the other hand, of the opinion that this Court in *Ball* held that the assignment, not being a mortgage in the ordinary sense, was not protected under 6323(a), I.R.C., 1954, from the impact of a subsequent federal tax lien and was therefore held to be inchoate. Perpetual contends that *Ball* did not constitute a holding that the choate lien test is applicable to a mortgage, but rather a refusal of this Court to extend the meaning of "mortgage" under Section 6323(a) to an instrument not a mortgage in form or substance. See *United States* v. *Gilbert Associates*, *supra*, wherein this Court rejected the contention of a municipality that its tax liens gave it the status of a judgment creditor under 6323(a). This Court in *Ball* was not called upon to decide, as it is in the case at bar, whether the choate lien test applies to a mortgage in view of Section 6323(a). *Ball* merely held that the assignment was not a mortgage and, as a consequence, was inchoate and inferior to the federal tax lien. Certainly, a full opinion

would have resulted if *Ball* had constituted a judicial limitation on the protection afforded mortgagees by Section 6323(a).

D. The Choate Lien Test as Applied to Defeat the Priority Accorded to Mortgagees Under Section 6323(a), I.R.C., 1954

In *United States* v. *Christensen*, 269 F. 2d 624, relied on by the United States below, the United States Court of Appeals for the Ninth Circuit, citing *United States* v. *New Britain*, *supra*, preferred a federal tax lien to the claim of a mortgagee for local real estate taxes paid by the mortgagee after the federal tax lien arose. The Court, ignoring the argument of the mortgagee that the payment of the local taxes were secured by the mortgage *ab initio*, construed Section 6323(a), I.R.C., 1954, to provide that a federal tax lien is invalid against the interest of a prior mortgagee as reflected in the outstanding balance for principal and interest secured by the mortgage at the time notice of the federal tax lien is filed. It is significant that the court also summarily dismissed the citation to *United States* v. *Bess*, *supra*, with no attempt in its opinion to either apply or distinguish that case.

The mortgagee has almost universally been preferred with respect to attorneys fees and similar expenses incurred subsequent to the filing of a federal tax lien. See *Ormsbee* v. *United States*, S.D. Fla., 23 F. 2d 926; *United States* v. *Sampsell*, 9 Cir., 153 F. 2d 731; *United States* v. *Halton Tractor Co.*, 9 Cir., 258 F. 2d 612; *Smith* v. *United States*, D.C. Hawaii, 113 F. Supp. 702; *Bank of America Nat. Trust & Savings Ass'n.* v. *United States*, D.C.S.D., Cal., 84 F. Supp. 387, but see *in re New Haven Clock & Watch Co.*, 2 Cir., 253 F. 2d 577. The mortgagee has likewise been preferred as to

the real estate taxes paid subsequent to the filing of the federal tax lien. See *United States* v. *Miller*, D.C.S.D., Fla., 55-1 U.S.T.C., Par. 9484; cf. *United States* v. *Lord*, D.C.N.H., 155 F. Supp 105. In *Rikoon* v. *Two Boro Dress, Inc.*, 171 N.Y.S. 2d 19, the local taxes were preferred as an expense of sale under the New York Statute. In *Peoples Bank* v. *United States, D.C.N.D.*, Ga., 98 F. Supp. 874, the mortgagee was given priority over the federal tax lien for subsequent advances on an open-end mortgage. The case was reversed on appeal on the ground that the subsequent advance was a separate transaction unsecured by the lien of the first mortgage. See *United States* v. *Peoples Bank*, 5 Cir., 197 F. 2d 898. The United States Circuit Court of Appeals for the Second Circuit in *Pipola* v. *Chicco*, 2 Cir., 274 F. 2d 909 preferred a mortgagee whose mortgage had arisen after the federal tax lien, where the settling attorneys had failed to note the recorded tax lien, on the theory that the second mortgagee, having paid off the prior mortgage which had priority over the federal government, was entitled to the same priority as the first mortgagee. All of these cases disclose the overwhelming sentiment of the majority of the lower federal courts toward construing the federal tax lien strictly in cases involving a mortgagee.

II. THE CHOATE LIEN TEST IS NOT APPLICABLE TO A MORTGAGE

The choate lien test is not applicable to a mortgage because of the nature of the mortgage and also because of Section 6323(a), I.R.C., 1954. As we have seen, this Court has noted consistently, albeit in *dicta*, that a mortgage is more than a lien. See *Conard* v. *Atlantic Ins. Co.*, and *United States* v. *Maclay*, both *supra*. In Virginia, a mortgage is a conveyance and in equity

vests legal title in the trustee to the extent of the obligation secured. See *Larchmont Homes, Inc.* v. *Annandale Water Co.*, 201 Va. 178, 110 S.E. 2d 249.

Among the obligations secured by the instant mortgage was the duty of the mortgagee to pay the local real estate taxes on the mortgaged property. While at law the claim of a mortgage may be regarded as a lien, in equity it is regarded as an estate. More accurately, the mortgagee's interest is said to be an estate terminable upon a condition, to-wit: the performance of the covenants of the mortgage. The equitable estate of the mortgagee is not diminished by the federal tax lien which attaches only to the equity of redemption of the taxpayer. The mortgagor's equity of redemption is determined by the contract of the parties. Until such time as all covenants of the mortgage are fully performed, the property interest of the taxpayer in the mortgaged property is determined by the mortgage. It matters not whether a mortgage be classified as a lien *or* a conveyance. Throughout this Country a mortgage creates at the least an equitable estate in the mortgagee. For this reason, if for no other, subsequent federal tax liens do not attach to the estate of the taxpayer previously conveyed by a mortgage. See *United States* v. *Durham Lumber Co.*, and *Aquilino* v. *United States*, both *supra*.

Now let us examine the impact of Section 6323(a), I.R.C., 1954, *supra*, on the question presented. Section 6322, I.R.C., 1954, *supra*, provides that, unless another date is fixed by law, the federal tax lien arises when the tax assessment is made. Thus, this statute, originally Act of July 13, 1866, ch. 184, 14 Stat. 107, created a secret lien which could affect the rights of subsequent

creditors without their knowledge. In *United States v. Snyder*, 149 U.S. 210, the Supreme Court ruled that the federal tax lien, although unrecorded as required by state law, was valid against a purchaser without notice of it. As a result of this decision, Congress in 1913, Act of March 4, 1913, ch. 166, 37 Stat. 1016, amended the tax lien statute so that it protected mortgagees, purchasers and judgment creditors by requiring recordation of the federal tax lien in the local jurisdiction in order that it might be valid against such interests. This amendment is presently designated Section 6323(a), *supra*. It is to be noted that Section 6323(a), on its face, limits the effective date of the federal tax lien without an exception for cases arising under the insolvency statute.

Section 6323(a) is nothing more than a recording statute giving notice to certain classes of creditors who would otherwise be prejudiced by the secret lien for federal taxes created by Sections 6321 and 6322. The effect of Section 6323(a) is, however, of necessity, to give priority to mortgagees prior in time to the filing of the notice of the tax lien. If, under Section 6323(a), a mortgagee becoming such after the federal tax lien arises under Section 6322, is not affected by the tax lien, a mortgagee established as such prior to the inception of the tax lien under Section 6322 *a fortiori* is entitled to at least the same priority. Indeed, since the federal tax lien statute gives no priority to the federal tax lien, all liens arising before the federal tax is assessed should have priority as provided by state law, unless the taxpayer is insolvent, in which case a limitation on state-created liens is compelled to implement the insolvency statute. Section 6323(a), being a limitation on Section 6322, this Court is clearly justified in strictly construe-

ing the interests thereby excluded from the effect of the tax assessment. However, where the competing interests are created prior to the tax assessment, there appears to be no congressional imperative to limit the rule of "first in time is first in right" except in insolvency and, even there, the imperative has been qualified by judicial construction as we have seen. Unless priority for its tax liens is an attribute of the sovereignty of the United States, the propriety of the application of the choate lien test in the absence of insolvency to competing liens arising *prior to the assessment of the federal tax* would appear doubtful. In the instant case, the mortgage of Perpetual was executed July 13, 1955 and recorded July 15, 1955; the federal taxes were assessed on December 20, 1955.

The congressional intention that federal tax liens should be treated as other liens is evident from the Report of the United States House of Representatives when Section 6323 was adopted. In H. R. Rep. No. 1018, 62d Cong., 2d Sess. 1-2 (1912) the following is stated:

> * * * "A person proposing to buy the property of another could protect himself against such a lien only by ascertaining from all the collectors in the United States whether or not the vendor was delinquent in the payment of taxes. This would be a great hardship and would make it practically impossible for any person proposing to buy property to secure himself against such liens. The same hardship would devolve upon mortgagees and judgment creditors. . . . (The amendment) provides a very simple means of giving this notice that would not at all be burdensome upon the Government. . . . The recent act relating to excise tax by corporations makes it imperative that some legislation of this kind be enacted in order to pro-

tect the transfer of property, and to facilitate business transactions. *There is no reason why the government should not occupy the same position with reference to liens on property as does the individual.*" (Italics mine)

While Congress in enacting Section 6323(a), was not concerned to protect local statutory liens as against the federal tax lien, Congress, by the same token, certainly did not intend to restrict the right of an antecedent mortgagee to protect itself contractually against state taxes. Nor did Congress intend that this contractual protection, as integral to the mortgage as all other obligations secured thereunder, should be vitiated by a federal tax lien subsequent to the mortgage. The contest here is not between a state-created lien and the federal lien; rather, it is between the mortgagee and the federal tax lien. The priority of the federal tax lien over the state tax lien is irrelevant to the issue presented.

Even if the choate lien test be applied, the mortgagee should prevail. It is obvious that the identity of the lienor and the property subject to the lien are established upon execution of the mortgage. If there is any uncertainty, it is as to the amount of the lien. All that is required in this regard is that the obligation secured by the mortgage be sufficiently identified. See the dissenting opinion in *United States* v. *R. F. Ball Constr. Co., supra.* It is submitted that the requirement of the certainty of amount arose out of and is solely applicable to the garnishment, attachment, mechanic's lien and landlord's lien cases where the amount of the lien would be subject to subsequent litigation wherein the amount claimed by the lien would be liquidated; in which cases, it was

obvious that the amount for which the lien was filed might not be the amount ultimately determined to be due. Further, in these cases, there was something more that the creditor had to do and, presumably, could have done to perfect his claim prior to the effective date of the federal tax lien against him. Obviously, Perpetual in the instant case was powerless to prevent the accrual of local real estate taxes or to remove the lien of these taxes from the security if the mortgagor-taxpayer failed to pay them as he covenanted to do in the mortgage. Accordingly, the lien of the local real estate taxes was anticipated by the provisions of the mortgage whereby the covenant to pay said taxes was secured by the mortgage. The Court of Appeals in its opinion rejected the citation to *United States* v. *Seaboard & Citizens Nat. Bank*, 4 Cir., 206 F. 2d 62, for the proposition that the mortgage from its inception secured the payment of the local taxes and the attorneys fees. In that case, an automobile subject to a chattel trust was seized by the government for violation of the Internal Revenue laws. The automobile was ordered sold by the District Court and a controversy arose over whether the remittance, based on the mortgagee's interest, should include a 15% attorneys fee as secured by a covenant of the mortgage. Judge Parker, writing for a unanimous court, 206 F. 2d 62, 63, upheld the continuing validity of a covenant in an antecedent mortgage over intervening federal claims as follows:

> * * * "It is argued that the attorneys fees were incurred after the seizure of the automobile and that, since the foreclosure became absolute at that time, remission under the statute should not cover attorneys fees subsequently earned. The answer is that, prior to the seizure, the mortgage secured

the debt to the bank and expenses which might be incurred in collecting it, including attorneys fees, and that in remitting the interest of the mortgagee from the forfeiture incurred by the mortgagor, there is no reason to exclude any part of the obligation secured by the mortgage."

The Court of Appeals, App., *infra*, pp. 24a-26a, distinguished *Seaboard & Citizens* on the ground that the federal statute involved was not the federal tax lien statute. The *Seaboard* case represents a determination by a federal court that under Virginia law the entire debt is secured by the mortgage from its inception including any provision for attorneys fees. It is submitted that, the mortgage in this case having arisen prior to the assessment of the federal tax against the mortgagor, there is no reason to restrict state law construing the interest created by the mortgage. This court held in *United States* v. *Security Trust & Sav. Bank*, *supra*, that the state's classification of a lien is entitled to weight, but subject to re-examination by this court.[3]

The situation of Perpetual here should be contrasted with the situation in *United States* v. *R. F. Ball Constr. Co.*, *supra*. In that case, the surety, in the face of the recorded federal tax lien, assumed for another consideration further liability on behalf of the taxpayer in a situation where there was no obligation to assume such further obligation. The obligation assumed bore no relation to the original assignment except as it purported to be secured by it. The surety, in assuming the further liability in the face of the federal tax lien, was not acting to protect the initial security since the original contract had been performed and, presumably, the taxpayer had fulfilled its obligations

thereunder. Certainly in such a case the surety is in a much weaker position than Perpetual here.

In Arlington County, Virginia, the situs of the mortgaged property, real estate taxes: (1) constitute a lien on property prior to any other lien or encumbrance;[2] (2) are a lien on the fee simple estate in real estate;[3]

[2] § 58-1023, Code of Virginia, 1950. LIEN ON REAL ESTATE FOR TAXES AND LEVIES.—There shall be a lien upon all real estate for the taxes assessed and county, district, city and town levies assessed thereon, prior to any other lien or encumbrance thereon. The words "taxes" and "levies", as used in this section, include the penalties and interest accruing on such taxes and levies in pursuance of law.

[3] § 58-1024, Code of Virginia, 1950. TAXES IN CERTAIN CITIES AND COUNTIES A LIEN ON FEE SIMPLE ESTATE, NOT MERELY ON INTEREST OF OWNER.—In any city totally surrounded by a county which has adopted and in which there is in effect the county executive form of county organization and government as provided by §§ 15-272 to 15-304, and in any county of the Commonwealth which has adopted and in which there is in effect the county executive form of county organization and government as provided by §§ 15-272 to 15-304:

(1) Taxes assessed against real estate subject to taxes shall be a lien on the property and the name of the person listed as owner shall be for convenience in the collection of the taxes. The lien for taxes shall not be limited to the interest of the person assessed but shall be on the entire fee simple estate. There shall be no lien when for any year the same property is assessed to more than one person and all taxes assessed against the property in one of the names have been paid for that year.

(2) When taxes are assessed against land in the name of a life tenant or other person owning less than the fee or owning no interest, the land may be sold under §§ 58-1014 to 58-1020 or any other laws for the sale of land for delinquent taxes provided the owner of record or his heirs be made parties to the proceeding for sale.

(3) Proceedings for the sale of land under such sections may be instituted any time after the five per centum penalty is added.

and (3) subject land to sale for delinquent taxes.[4] The tax lien is superior to all prior encumbrances. See *Simmons* v. *Lyles*, 32 Gratt. (73 Va.) 752; *Thomas* v. *Jones*, 94 Va. 756, 27 S.E. 183; *Stevenson* v. *Henkle*, 100 Va. 591, 42 S.E. 672. Perpetual's payment of the real estate taxes involved prevented the imposition of a prior lien on the mortgaged property. No case has been found in Virginia ruling upon the priority of payments pursuant to a mortgage over the rights of subsequent lienors. A mortgage (as in the case at bar, the instrument was a deed of trust) for future advances was approved in principle in *Alexandria Sav. Institution* v. *Thomas*, 29 Gratt. (70 Va.) 483, wherein the competing claimant obtained a judgment after all advances had been made under a mortgage given solely to secure future advances. This case supports the proposition that, where a mortgage is bound by contract to make future advances, priority over subsequent encumbrances is afforded to such advances. See 29 Gratt. 483, 489 as follows:

> * * * "The cases are generally agreed that when the mortgagee is bound by his contract with the mortgagor to make advances or incur liabilities in the future, he will take precedence over any subsequent encumbrance given by the mortgagor although he may have had actual notice of such encumbrance at the time the advance was made or the liability incurred."

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[4] § 58-1029, Code of Virginia, 1950. WHEN TREASURERS TO SELL DELINQUENT LAND.—On the second Monday in December in the year next after the year in which the treasurers submit their lists of delinquent real estate to the boards of supervisors of their counties and the councils of their cities, as required by § 58-983, each such treasurer shall sell, as hereinafter provided, all the real estate embraced in his list of delinquent real estate, on which the levies for which the same was returned delinquent, or any part thereof, may remain unpaid on the day of sale.

The imperative for the payment for local taxes and attorneys fees in the case at bar is not contractual albeit such payments were authorized by the contract. The obligation to incur the expenditures in question to protect the security is nonetheless compelling within the rule recognized above.

It should be noted in this regard that the 1957 taxes were paid by Perpetual prior to the institution of the instant litigation, at which time Perpetual was not charged with notice of the federal tax lien. The 1958 taxes, on the other hand, and the attorneys fees were incurred after the institution by the United States of this proceeding to enforce its liens. The state of the law with regard to the right of the mortgagee to remove a junior federal tax lien by foreclosure in the ordinary manner or by exercise of the power of sale in the deed of trust of Perpetual prior to the decisions of this Court handed down June 13 of this year in *United States* v. *Brosnan*, and *Bank of America* v. *United States*, October Term 1959, Nos. 137 and 183, respectively, placed Perpetual in a position where it could not, by its own action, remove the federal tax lien except by proceeding under 28 U.S.C., Section 2410, in which proceeding the title would have been unmarketable because of the one year right of redemption in the federal government. As a consequence, Perpetual could not avoid holding the property for at least one year and felt advised to await proceedings by the United States to foreclose its lien, in which proceeding Perpetual would not be compelled to purchase the property. Certainly Perpetual's position should not be prejudiced with respect to the priority of its mortgage because of the accrual of the subsequent tax liabilities while the lien of the United States was being enforced. Even the most

succinct and cogent rationale supporting such a decision could not allay the patent injustice of such a result.

III. EXPENDITURES BY A MORTGAGEE PRIOR IN TIME TO THE FEDERAL TAX LIEN FOR ATTORNEYS FEES TO PRESERVE THE PRIORITY OF THE MORTGAGEE ARE ENTITLED PRIORITY OVER THE FEDERAL TAX LIEN

The rationale for priority for the attorneys fees incurred by Perpetual over the federal tax lien is the same as the rationale for priority for the sums paid for local real estate taxes. The estate of the mortgagor-taxpayer was reduced upon the execution of the mortgage by the conveyance of the mortgaged property as security for the payment of any attorneys fees expended to preserve the priority of the security. Likewise, under Section 6323(a), I.R.C., 1954, *supra* the mortgagee is preferred to the federal tax lien to the extent of the covenant securing expenses incurred in protecting the priority of the mortgagee.

CONCLUSION

The writ of certiorari should be granted and the judgment of the United States Court of Appeals for the Fourth Circuit reversed.

Respectfully submitted,

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APPENDIX

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

At Alexandria

Civil 1598

UNITED STATES OF AMERICA, *Plaintiff*

v.

V. F. BOND, et al., *Defendants*

Memorandum by the Court on Reimbursement of Mortgagee for Real Estate Taxes

The mortgage of Perpetual Building Association upon the real estate of one Bond and his wife, situate in Arlington County, Virginia, is concededly superior to the lien of the United States for income taxes against the Bonds, the mortgage having been recorded (in form a deed of trust) on July 15, the tax lien December 20, 1955. IRC of 1954, sections 6321 and 6323(a), 26 USCA 6321, 6323(a).* Now

*"§6321. Lien for taxes

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

"§6323. Validity against mortgagees, pledgees, purchasers, and judgment creditors.

"(a) Invalidity of lien without notice.—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—"

NOTE—Although the mortgagor-taxpayers have in this suit been found insolvent, the United States has not specifically urged prior-

the question is whether the mortgagee also has the same primacy for 1957 and 1958 County real estate taxes (admittedly of higher rank than the mortgage) paid by Perpetual after the inception of the Federal lien, the 1957 taxes before, and the 1958 after, suit begun by the Government. Moneys from the sale of the property are not enough to pay all three liens. The question presented was advertently not resolved in United States v. New Britain, 347 U.S. 81, 87, note 12 (1954). Nor was it reached in United States v. City of Greenville, 4 cir. 118 F.2d 963 (1941).

Perpetual prevails here. Anticipated and authorized by the mortgage, the real estate taxes were paid by Perpetual, upon failure of the mortgagor so to do, solely to maintain the integrity of its lien. Such outlays thereupon became secured under the mortgage, evenly with the loan and by a lien of equal dignity, and hence outranked the Government's taxes. Cf.: United States v. American National Bank of Jacksonville, 5 cir. 255 F.2d 504, 505, 507, 509 (1958) cert. denied 258 U.S. 835; and United States v. Seaboard Citizens Nat. Bank, 4 cir. 206 F.2d 62 (1953).

I. To defeat Perpetual as the primal lienor for the recapture of the land taxes, the Government's argument is doubly grounded. First: that in seeking refund of the taxes the mortgagee stands as the subrogee of the County, and, as the income taxes attached earlier, they are paramount to the property taxes, and so the subrogee is subordinated to the United States. Second: that payment of the property levies constituted future, optional advances, and these can never be added to a mortgage debt to the

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ity on the basis of Rev. Stat. 3466, 31 USC 191, giving the United States priority in the distribution of insolvent estates. However, that statute in the circumstances would not advantage the Government beyond sec. 6321 supra, because the former is also subject to preexisting valid mortgages. Brent v. Bank of Washington, 10 Pet. 596,611 (1836).

prejudice of an intervening junior lienor, as is now the United States.

The frailty of this argument is, initially, that the claim for reimbursement does not invoke subrogation; it relies exclusively on the terms of the mortgage. Next, the subject of the recoupment was not an advance, but rather a maintenance expenditure. 1 Glenn on Mortgages (1943) sec. 43, p. 273. Nor was the payment volitive—the taxes were fixed in amount, and ineradicably impressed upon the property, by law. Nor was the payment post-contractual—it was an explicit undertaking of the mortgage ab ovo.

Future advancements, in relation to mortgages, do not include moneys spent to preserve the encumbered property, such as premiums for insurance, custodial costs, restoration expenditures, attorney's fees, taxes assessed and assessable, and similar items rooted in the res. Authoritative discussions of the subject never give these the character of future advances. 3 Glenn on Mortgages, supra, sec. 392, p. 1592, ff.; Osborne on Mortgages (1951) sec. 113, p. 276, ff.; United States v. American Nat. Bank of Jacksonville, supra, 255 F.2d 504.

II. But if the instant tax payments be classed as future advancements, they at once qualify for validity. As noted, neither the amounts, nor the foreseeability, nor the inevitability of the taxes rested on the agreement of the mortgagee. Moreover, the promise of the mortgagor to pay them is written as plainly within the mortgage as is the principal debt. It was not a supervening obligation of the mortgagor, nor an additive disbursement to or for the mortgagor—it was always immanent in the mortgage.

Again, what is required of a mortgagee is determinable by what objectively is demanded to sustain the position of the mortgage—not what personally the mortgagee may elect to do. In default of the owner, a mortgagee pays taxes not merely permissively or optionally, but dutifully.

It is necessary to maintain the security. Elsewise, the security would be jeopardized by the incurrence of interest and penalties, by a sale for taxes and by attendant expenses, possibly suit costs and fees. All these sums would have priority over the mortgage lien.

Of course, the mortgagee may foreclose at once for nonpayment of taxes. So, too, he may for default in interest or principal. But, surely, his indulgence of the mortgagor in further time, would not prefer an otherwise inferior lienor to the mortgagee. Similarly, the mortgagee's forbearance or payment of the taxes could not possibly impair his precedence over a junior lienor.

III. With the covenant to pay real estate taxes a real attribute of the mortgage—as essential as the promise to pay the debt secured—the statute, sec. 6323(a) supra, subordinating Federal taxes to the mortgage must at the same time place them behind the covenant. It is immaterial, therefore, whether the mortgagee paid the taxes, or left them to be paid out of the proceeds of the foreclosure sale in the same manner as the debt. In the latter event the property taxes would be satisfied, according to the mortgage terms, before the Federal lien could touch the proceeds—and the present suit and sale are the equivalent of foreclosure. For the same reasons, no significance is to be found in the 1958 payment having been made by the mortgagee after actual notice (through process in this suit) of the Government's lien.

Unless the statute be so read it will not give the protection intended. This is not to allow a mortgagor-mortgagee agreement to relegate Federal to State taxes. Of course even a local statute could not do that. But it is the recognition of a common term of a mortgage as commonly accepted. If this is not the interpretation of the statute, then a mortgagee can never secure himself, for almost universally land taxes are by State law superior to mort-

gages. No matter how adequate the security originally, or how cautious the mortgagee, subsequent tax involvements of the mortgagor beyond the provision of the lender would, otherwise, in every situation cause the mortgagee to lose the amount of the real estate taxes, whether current or delinquent. This results from the generally followed rule of marshaling in a circuity of liens, as exists here—one lien ahead of a second, the second ahead of a third, and the third ahead of the first-named. Exchange Bank & Trust Co. v. Tubbs Manufacturing Co., 5 cir. 246 F.2d 141, 143 (1957) cert. denied 355 U.S. 868, 920 and note 6 with regard to disposition in the State court on remand of United States v. New Britain, supra, 347 U.S. 81; Smith v. U.S., D.C. Hawaii 113 F.Supp. 702, 711 (1953); Samms v. Chicago Title & Trust Co., 349 Ill. App. 413, 111 N.E.2d 172 (1953); 67 Harvard Law Rev. 358 (1953); 63 Yale Law Journal 905, 927 (1954) and at 928, "Such an allocation, however, would violate the federal policy of protecting the mortgagee * * *."

So marshaling now, the amount of the mortgage, principal and interest only, would be segregated from the sale proceeds, the balance paid to the United States, and the land taxes thereafter paid from the mortgage allocation or, rather, since they have already been paid, they would not be reimbursed. To say this is the action of State law is to cavil. The squeeze is forced by the Federal lien. To allow it is to sterilize the statute—according the junior lien of the Government priority over the mortgage.

If the ordinary mortgage covenant for the payment of taxes does not prevent this unjust result, surely the instant mortgage does so with its peculiar provisions. The mortgagor agrees to pay each month not only an amount in interest and amortization of the loan, but also a calculated sum sufficient, when aggregated over a period of months, to meet accruing taxes and insurance premiums. No amount for the periodical curtail is fixed, in figures, either in the

note or the mortgage securing it. The sum due on the loan each month is "as provided by or under the Constitution and By-laws" of the Perpetual Building Association. The mortgagor under this arrangement has an account with the mortgagee, pays monthly on the account and the payments are applied, when accumulated, to taxes and insurance. Taxes on the property are, thus, the more immediately secured by the mortgage.

In conclusion, the controversy here is not the pre-eminence between National and local taxes. The only issue is how comprehensive is the mortgage contemplated by sec. 6323(a). The decision is that the statute embraces every vital covenant of the mortgage.

Let an order be presented effectuating these views, which are now adopted as the fact findings and law conclusions of the court.

(Sgd.) ALBERT V. BRYAN
United States District Judge

Charleston, South Carolina.
March 26th, 1959.

Memorandum by the Court on Mortgagee's Claim for Attorney's Fees

A separate controversy in this case arises from the claim of Perpetual Building Association for an allowance of an attorney's fee out of the proceeds of sale. Aside from the quantum of the fee, the United States contests the request on the ground that it is not chargeable under the mortgage. More exactly, the Government concedes that the mortgage entitles Perpetual to reimbursement for counsel fees; but it denies that the present claim comes within this provision. The argument is that the United States having granted priority to the mortgage, counsel was not needed except to put the mortgage before the court.

But, the fact is, Perpetual's attorney not only came in to establish its lien, but additionally to resist dimunition of it by the Government's assertion of predominance for the income taxes over reimbursement of the real estate taxes. The court does not agree that the latter services were not, as well, under the mortgage. Counsel did more than observe a tax contest between the Bonds and the Government. Obviously, the chief contestant with the United States on this issue was Perpetual. A fee of $1,000.00 will be awarded, payable from the proceeds of sale as a cost of liquidating the mortgage.

Let an order to this effect be presented, this memorandum serving as findings of fact and conclusions of law.

(Sgd.) ALBERT V. BRYAN
United States District Judge

March 20th, 1959.

Opinion

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7987

UNITED STATES OF AMERICA, *Appellant*,

v.

V. F. BOND, AUDREY A. BOND, et al., *Appellees*.

Appeal from the United States District Court for the Eastern District of Virginia, at Alexandria. Albert V. Bryan, District Judge.

(Argued January 8, 1960. Decided May 31, 1960.)

Before Sobeloff, Chief Judge, and Haynsworth and Boreman, Circuit Judges.

David O. Walter, Attorney, Department of Justice, (Charles K. Rice, Assistant Attorney General, Lee A. Jackson and A. F. Prescott, Attorneys, Department of Justice, John M. Hollis, United States Attorney, and Henry St. J. FitzGerald, Assistant United States Attorney, on brief) for Appellant; and Dillard C. Laughlin (Jesse, Phillips, Klinge & Kendrick on brief) for Appellees.

BOREMAN, Circuit Judge:

The principal question for decision is whether a tax lien of the United States is prior in right to payments of real estate taxes made by the mortgagee under a prior recorded mortgage, the taxes having accrued and the payments having been made subsequent to the recordation of the notice of federal tax lien. In addition, there is a question of

priority as between the federal tax lien and an attorney fee allowed by the District Court for payment to the mortgagee out of the proceeds of the sale of the mortgaged property.

The United States brought this action in the United States District Court for the Eastern District of Virginia on October 29, 1957, for the foreclosure of tax liens upon property and rights to property of appellees, the taxpayers.

There is no dispute as to pertinent facts. On December 20, 1955, deficiencies were assessed against the taxpayers for the years 1943 through 1947, totaling $318,832.84, and on the same day deficiencies were assessed against taxpayer, V. F. Bond, for the year 1942 in the amount of something over $18,000.00. On or about December 20, 1955, notices of such assessments were served upon the taxpayers and demand for payment was made but taxpayers refused to pay.

On December 21, 1955, notice of lien for each assessment was recorded in the proper county and municipal offices pursuant to 26 U.S.C.A. § 6323(a)(1). On July 2, 1957, the assessments had been reduced to judgment.

The complaint listed various properties owned by the taxpayers, among them being the Arlington Hotel, at Arlington, Virginia, the property and the proceeds of sale thereof involved in controversy before this court. The United States requested the appointment of a Receiver to take charge of, marshal and liquidate the properties, and prayed inter alia that the court determine the validity and priority of all liens and claims and order a foreclosure of the liens of the United States and a sale of the properties.

On November 27, 1957, the District Court found that the United States had valid liens in the principal sum of $357,484.18, plus interest, for the years involved, and that the taxpayers were insolvent. The court then appointed a Custodial Receiver to take charge of the properties of the taxpayers and appointed a Special Master to ascertain and

report to the court the claims against the taxpayers, the value of their properties and the validity and priority of liens on such properties. Pursuant to the recommendations of the Receiver, the Arlington Hotel property was sold for $172,500.00.

The Arlington Hotel property was subject to a mortgage,[1] executed by taxpayers as mortgagors, securing a loan in the original principal sum of $100,000.00 made by Perpetual Building Association, hereinafter called "Perpetual". This mortgage was recorded on July 15, 1955, some six months prior to the recordation of the notice of federal tax lien. Monthly payments were made by the mortgagors until October 4, 1956, after which no further payments were received by Perpetual.

Under the mortgage each monthly payment was allocated not only to the payment of principal and interest, but a portion, $331.00, was also set aside in a fund for the payment of taxes accruing against the mortgaged property. The mortgage contained other provisions as follows:

> "*It Is Hereby Covenanted*: * * * (2) that any and all taxes and assessments, general or special, now or hereafter assessed against said realty shall be paid when due, * * * (7) that the title to said realty and the record of said title shall be kept free of litigation, infirmity and lien, * * * (10) that any and all disbursements made by the Treasurer [of Perpetual] because of the failure of the grantor to make any payment or do any act required to be made or done, with interest thereon at six percent (6%) per annum, shall be demandable at any time by the Treasurer and, until repaid to the Treasurer, shall be deemed to be secured by this Deed of Trust, and (11) that if there shall be

[1] The instrument was actually a deed of trust, but there is no dispute that it qualified as a "mortgage" within the meaning of 26 U.S.C.A. § 6323(a). See Fn. 4.

any default in the performance of any of the foregoing covenants the Treasurer shall have the right and power to do any one or more of the following: (a) do any act or make any disbursement, in his name or the name of the grantor, which he may deem necessary or proper to protect the lien of this Deed of Trust, * * *."

After default by the mortgagors, Perpetual paid the local real estate taxes assessed for the years 1957 and 1958 which had accrued and had been assessed subsequent to the recordation of the notice of federal tax liens. While a portion of the payment made for 1957 taxes came from the accumulated fund paid and held for this purpose, Perpetual paid from its own funds on August 16, 1957, $4,759.16 for the year 1957 and on August 11, 1958, $4,787.16 for the year 1958. Perpetual claims that it has a lien for those amounts, with interest, by virtue of the provision of the mortgage, and that such lien is prior to the federal tax liens.

The District Court (United States v. Bond, 172 F. Supp. 759) held that Perpetual was entitled to be reimbursed for the real estate taxes paid by it, prior to the lien for federal taxes. In a separate unreported memorandum opinion, the court allowed an attorney fee of $1,000.00, payable to Perpetual from the proceeds of sale as a cost of liquidating the mortgage, the attorney fee to take priority also over the federal tax liens. From these decisions United States appeals.

The United States contends that in determining priorities, where a federal tax lien is involved, the "inchoate lien test" is applied so as to defeat the competing lien if it be shown that the competing lien was uncertain and inchoate at the time of the recordation of the federal tax liens. Therefore, it is urged that since both the necessity and amount of the local real estate taxes and attorney fee were uncertain at the time the federal tax liens were recorded, both must necessarily be inferior and junior in priority to the federal tax

liens. Perpetual, on the other hand, contends that 26 U.S.C.A. § 6323(a) gives priority to a prior recorded mortgage over a federal tax lien not only as the mortgage debt but also as to the covenants and provisions contained in the mortgage and payments made by mortgagee thereunder; and that the inchoate lien test is not applicable here.

The federal tax lien was created by statute many years ago and present enactments are identified as § 6321 [2] and § 6322 [3] of the Internal Revenue Code of 1954. For the lien to become valid and effective under these sections, notice, filing or recording are not required. Section 6322, originally Act of July 13, 1866, ch. 184, 14 Stat. 107, was considered in United States v. Snyder, 149 U.S. 210 (1893), wherein the Supreme Court of the United States held that an unrecorded tax lien was valid against a purchaser without notice thereof. This decision prompted Congress to at least partially abrogate the effect of the secret, unrecorded lien, and by Act of March 4, 1913, ch. 166, 37 Stat. 1016, the tax lien statute was supplemented by requiring *recordation* of the federal tax lien to render it valid as against mortgagees, pledgees, purchasers and judgment creditors. Under the Internal Revenue Act of 1954, this is designated

[2] 26 U.S.C.A. § 6321. Lien for taxes

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

[3] 26 U.S.C.A. § 6322. Period of lien

"Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time."

§ 6323(a).[4] While § 6323(a) is not a priority statute as such, if it is to have any meaning its necessary effect is to give priority to the interests mentioned therein.

31 U.S.C.A. § 191, R. S. 3466,[5] is a statute which purports to fix priority of debts due the United States where the debtor is insolvent. While the priority of such debts mentioned in this statute would appear to be absolute, it was held in Brent v. Bank of Washington, 10 Peters, 596 (1836), that this priority in insolvency cases is not to supersede prior encumbrances, including mortgages. The court there said that it had *never* been decided that the preference given the United States would affect any lien, general or specific, existing "when the event took place which gave the United States a claim of priority." In the instant case, even though the court found insolvency of taxpayers, the United States did not present, before the District Court, any claim of priority under this insolvency priority statute

[4] 26 U.S.C.A. § 6323. Validity against mortgagees, pledgees, purchasers, and judgment creditors

"(a) Invalidity of lien without notice. Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate.

"(f) Under state or territorial laws. In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; * * *"

[5] 31 U.S.C.A. § 191. Priority established

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed." R. S. § 3466."

and, for that reason, it is precluded from first raising the point here. 36 C.J.S. *Federal Courts* § 292(b)(1) (1943).

Several cases have been decided by the Supreme Court of the United States involving the application of the insolvency priority statute, 31 U.S.C.A. § 191, and while a discussion thereof may serve no real purpose here, we note them to indicate that, in insolvency cases, the Supreme Court considered and determined the question as to whether *state created* liens were so specific, perfected and choate as to be accorded priority over federal tax liens. In establishing the "choate lien test", these cases have developed exacting requirements, the substance of which is to require that the state created liens be specific to the point that nothing further need be done to make the lien enforceable. See United States v. Gilbert Associates, 345 U.S. 361 (1953); United States v. Waddill Co., 323 U.S. 353 (1945); United States v. Texas, 314 U.S. 480 (1941); New York v. Maclay, 288 U.S. 290 (1933).

United States v. Security Trust & Sav. Bank, 340 U.S. 47 (1950), extended the application of the choate lien test to a statutory attachment lien on property in California obtained under California law. No insolvency question was presented. The court said that in cases involving federal priority under the insolvency statute, 31 U.S.C.A. § 191, R. S. § 3466,

> "* * * it has never been held sufficient to defeat the federal priority merely to show a lien effective to protect the lienor against others than the Government, but contingent upon taking subsequent steps for enforcing it. * * * *If the purpose of the federal tax lien statute to insure prompt and certain collection of taxes due the United States from tax delinquents is to be fulfilled, a similar rule must prevail here.* * * *" (Emphasis supplied).

The court held that the federal tax lien was superior to the inchoate attachment lien. In a concurring opinion, Mr.

Justice Jackson expressed the view that the statute (§ 6323 (a)) excludes from the operation of the secret lien those types of interests which are specifically set forth in the statute *and no others.*

United States v. New Britain, 347 U.S. 81 (1954), brought before the Supreme Court the question of the "relative priority of statutory federal and municipal liens to the proceeds of a mortgage foreclosure sale of the property to which the liens attached." There, two mortgages on the real estate of a corporation located in the City of New Britain, Connecticut, were foreclosed by judgment sale. Against the fund thus created were the claims of the two mortgages, a judgment of record and various statutory liens asserted by the City and by the United States. The Connecticut state court gave priority to the City's liens, the mortgages, the judgment lien and the federal tax liens in that order. The United States appealed from the judgment insofar as the statutory liens of the City were given priority over those of the United States. The record did not disclose insolvency of taxpayer. Since the holding in that case represents an important step in the development of the law by which we find ourselves now controlled, careful analysis is warranted.

In New Britain, the federal tax liens, resulting from unpaid withholding and unemployment taxes and insurance contributions, arose on various dates between April 1948 and September 1950. The City's liens, which attached to the specific real estate sold, were for delinquent real estate taxes and water rents which became due and which attached on various dates between 1947 and 1951. Certain of the City's liens were specific and became choate prior to the attachment of some of the federal tax liens. At 347 U.S., pages 84 and 85 (we omit footnote references), the court said:

> "* * * However, we accept the holding as to the specificity of the City's liens since they attached to specific

pieces of real property for the taxes assessed and water rent due. The liens may also be perfected in the sense that there is nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien, and the amount of the lien are established. The federal tax liens are general and, in the sense above indicated, perfected. But the fact that one group of liens is specific and the other general in and of itself is of no significance in these cases involving statutory liens on real estate only. * * *

"Thus, the general statutory liens of the United States are as binding as the specific statutory liens of the City. The City gains no priority by the fact that its liens are specific while the United Sates' liens are general. Obviously, the State cannot on behalf of the City impair the standing of the federal liens, without the consent of Congress. [Cases cited]. On the other hand, the federal statutes do not attempt to give priority in all cases to liens created under the paramount authority of the United States. The statute creating the federal liens here involved, I.R.C., § 3670, [now 26 U.S.C.A. § 6321] does not in terms confer priority upon them.

"When the debtor is insolvent, Congress has expressly given priority to the payment of indebtedness owing the United States whether secured by liens or otherwise, by § 3466 of the Revised Statutes, 31 U.S.C. (1946 ed.) § 191. * * * Where the debtor is not insolvent, Congress has failed to expressly provide for federal priority, with certain exceptions not relevant here, although the United States is free to pursue the whole of the debtor's property wherever situated. * * *

"It does not follow, however, that the City's liens must receive priority as a whole. We believe that priority of these statutory liens is determined by an

other principle of law, namely, 'the first in time is the first in right'."

Continuing on page 86 of 347 U.S., the court referred to the inchoate attachment lien involved in United States v. Security Trust & Sav. Bank, supra, and said:

"* * * Such inchoate liens may become certain as to amount, identity of the lienor, or the property subject thereto only at some time subsequent to the date the federal liens attach and cannot then be permitted to displace such federal liens. Otherwise, a State could affect the standing of federal liens, contrary to the established doctrine, simply by causing an inchoate lien to attach at some arbitrary time even before the amount of the tax, assessment, etc., is determined. Accordingly, we concluded in *Security Trust* 'that the tax liens of the United States are superior to the inchoate attachment lien * * *'. * * * In the instant case, certain of the City's tax and water-rent liens apparently attached to the specific property and became choate prior to the attachment of the federal tax liens."

The Connecticut court, from which the appeal was taken in New Britain, suggested that the mortgagee could have paid the delinquent real estate taxes and water rents; that the amount so paid would become part of the mortgage debt covered by the mortgage lien; and that the federal tax lien would, therefore, be invalid as to such amount by virtue of then § 3672, now 26 U.S.C.A. § 6323(a). While the Supreme Court declined to pass upon the merits of these suggestions since there had been no payment of City taxes and water rents by the mortgagee, it had this to say at page 88 of 347 U.S.:

"The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of

> state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. There is nothing in the language of § 3672 [now § 6323] to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interets set out therein, and the legislative history lends support to this impression."

The case was remanded to the Connecticut court for a redetermination of the order of priority of the various liens asserted.

In the instant case, Perpetual contends that the court, in United States v. New Britain, supra, abandons the choate lien test in noninsolvency cases but we reject this contention because it is clear that it did not do so; it merely held that not only must the competing lien be first in point of time, *but it must also be choate.*

Consistent with its prior position, the Supreme Court of the United States, in three opinions by Mr. Justice Minton, held that federal tax liens were entitled to priority over the following:

> (1) An attachment lien under the laws of Ohio upon which judgment was not rendered until after recordation of the federal tax lien, United States v. Aeri, 348 U.S. 211 (1955);
>
> (2) A garnishment lien under the laws of Texas upon which judgment was not rendered until after recordation of the federal tax lien, United States v. Liverpool & London & Globe Ins. Co., 348 U.S. 215 (1955); and
>
> (3) A landlord's distress lien obtained after the attachment of the federal tax lien but before it was recorded, United States v. Scovil, 348 U.S. 218 (1955).

In all of these cases, the competing liens were recorded prior in time to the federal tax lien, but they did not meet the other requisite established by the Supreme Court in New Britain, namely, *that the lien must also be choate.* As a basis for its conclusion in Acri and Liverpool & London & Globe Ins. Co., the Court simply refused to accept the state court's characterization of the lien as perfected and choate, and in Scovil it was held that a landlord is not a "purchaser" within the meaning of § 6323(a) (then § 3672) so as to be accorded priority.

Following the decision in United States v. Scovil, supra, the majority of the Supreme Court has spoken on this subject only five times and in each case by per curiam opinion. Three of these five opinions are neither enlightening nor helpful there. In United States v. Colotta, 350 U.S. 808 (1955), and United States v. Vorreiter, 355 U.S. 15 (1957), the court subordinated mechanics' liens to federal tax liens, and in United States v. Hulley, 358 U.S. 66 (1958), subordinated a prior recorded materialman's lien to federal tax liens. Since the Supreme Court did not clearly indicate its reason for such subordination, we are left to surmise and conjecture. However, it would seem that the cases could have turned on one or both of two theories: (1) The subordinated liens did not meet both the prior in time *and* choate tests; or (2) such liens are not protected interests under § 6323(a).

Dissenting opinions were filed in the other two cases decided by the Supreme Court since the decision in United States v. Scovil and thus some discussion is merited. In the first of these cases, United States v. White Bear Brewing Co., 350 U.S. 1010 (1956), the court summarily, and without citation of authority, reversed a decision of the United States Court of Appeals for the Seventh Circuit and held that a federal tax lien had priority over a recorded mechanics' lien, specific in amount, and on which a suit for enforcement had been instituted before the federal tax lien

arose. There the only thing remaining to be done was the granting of a *final judgment* enforcing the lien. Mr. Justice Douglas dissented on the theory that the mechanics' lien was specific and perfected insofar as it could be under state law and said that, under the majority opinion, it would be impossible for a competing lien to ever prevail against a subsequent federal tax lien, short of reducing the competing lien to final judgment. He felt that the holding of the majority was not warranted by prior decisions and was supportable only if United States v. New Britain were overruled. We venture to suggest our impression that the conflict between the majority and dissenters in United States v. White Bear may have arisen from a difference in interpretation of "choate lien" and not, as Perpetual suggests, that the real test is "prior in point of time" as opposed to "choate lien". At no place in either the majority or dissenting opinions is it suggested that a mechanics' lien was not a protected interest under § 6323(a).

The second of the cases (in which there was a dissenting opinion) decided since United States v. Scovil, namely, United States v. R. F. Ball Constr. Co., 355 U.S. 587 (1958), for the first time presented to the Supreme Court, for decision, the question of *priority between a nonstatutory contractual lien* and a *federal tax lien*. There a subcontractor was required to furnish a surety bond. To induce the surety company to issue the bond, the subcontractor assigned all sums due or to become due under the subcontract as collateral security for any liability the surety company might incur through non-performance of the subcontract, and for the payment of other indebtedness for liability of the subcontractor to the surety company whether theretofore or thereafter incurred, not exceeding the penalty of the bond. Subsequently, the subcontractor incurred indebtedness to the surety company, independent of the subcontract. Certain funds became due the subcontractor but payment was withheld because of outstanding claims of

materialmen against the subcontractor. Thereafter the United States filed federal tax liens against the subcontractor and the question was whether the assignment to the surety company made it a "mortgagee" within the meaning of § 3672(a) (now § 6323(a)). The majority of the court relied upon United States v. Security Trust & Sav. Bank, supra, and United States v. New Britain, supra, and held that since the assignment, the instrument involved, was inchoate and unperfected, the provisions of § 3672(a) did not apply. Mr. Justice Whittaker vigorously dissented and was joined by Justices Douglas, Burton and Harlan. It was their view that neither Security Trust nor New Britain was applicable because neither was primarily concerned with § 3672(a). Therefore, they were of the opinion that the assignment was, in legal effect, a mortgage and that inasmuch as it antedated the filing of the federal tax liens, it was superior to them under the express terms of § 3672(a). In summarizing the position of the dissenters, Mr. Justice Whittaker said:

> "* * * I think it is clear that the assignment was in legal effect a mortgage, completely perfected on its date, in all respects choate, and valid between the parties; and inasmuch as it antedated the filing of the federal tax liens it was expressly made superior to those liens by the terms of § 3672(a)."

Perpetual urges that the opinion of the majority in the Ball Construction Co. case could be supported only by a finding that the assignment was not a mortgage; and if the majority had determined that the protected interests mentioned in § 3672(a) should be subject to the choate lien test, there would certainly have been a full opinion announcing a decision of such moment. Perpetual's argument is unacceptable to us. The per curiam opinion in Ball Construction Co. clearly states the reason upon which the decision is based, namely, that the instrument is inchoate and unperfected. Both of the cases cited by the majority,

Security Trust and New Britain, set forth the choate lien test, a further indication of the basis of the court's opinion. Here again, as in United States v. White Bear Brewing Co., we venture to suggest a conflict between the majority and the minority as to the interpretation of "choate lien". However, we do not perceive any real conflict of opinion as to the applicable rule of law.

We have derived an indelible impression from the cases (involving determination of priority of federal tax liens over competing liens) decided by the Supreme Court, which reveal the persistent application of the choate lien test, *first in insolvency cases, then in statutory lien cases, and finally in nonstatutory contractual lien cases.*

The United States places great reliance upon the recent case, United States v. Christensen, 269 F.2d 624 (9th Cir. 1959). In that case, a mortgage had been executed on November 22, 1943, covering certain real property owned by the taxpayer. On January 19, 1950, federal tax liens were filed against mortgagor, taxpayer. On December 12, 1955, the United States instituted an action for the collection of the taxes and sought to foreclose its lien against the mortgaged property. On January 3, 1956, mortgagee redeemed a tax sale certificate for local real estate taxes on the mortgaged property and, on the same day, paid delinquent taxes on the same property. The District Court entered judgment which, though generally favoring the United States, gave the mortgagee priority over the federal tax lien for the amount remaining due under the mortgage and for the real estate taxes which mortgagee had paid. The United States appealed from that portion of the order which allowed priority of the real estate taxes paid after the federal tax liens were recorded, and the Court of Appeals reversed, relying primarily upon the case of United States v. New Britain, supra.

Although in its brief Perpetual contends that the Christensen case is distinguishable on its facts from the case at

bar, during oral argument counsel conceded that an examination of the record discloses factual similarity. In undertaking to discourage our acceptance of the Christensen decision, Perpetual presents the following arguments: (1) "although the case recites that the mortgagee contended for a contractual right to priority, the decision appears to have gone off on the questions of whether the priority of a federal tax lien is a federal question and whether the mortgagee, becoming subrogated to the right of the local taxing authority, might prevail over the federal tax lien"; and (2) "further, the mortgagee in Christensen does not appear to have argued the effect of § 6323(a) on the priority of lien question presented".

We believe these arguments to be without merit. First, while the court in Christensen did discuss the well settled principle that the priority of a federal tax lien is a federal question, it dismissed the mortgagee's contention of priority by subrogation to the rights of the local taxing authority and based its decision on the test set forth in United States v. New Britain. Although the opinion does not disclose that the mortgagee *argued* the effect of § 6323(a), the court did note that section and then applied the New Britain rule that the priority of the competing lien must depend *upon the time it attached and became choate*. As before stated, this rule was extended by the Supreme Court to nonstatutory contractual liens in United States v. R. F. Ball Constr. Co. [355 U.S. 587 (1958)]. Therefore, in view of the persistent application of the "choate lien test" by the Supreme Court, which doctrine was recognized and followed by the Ninth Circuit in United States v. Christensen, supra, we reach the conclusion in the instant case that the claimed priority for payment of the real estate taxes accruing after recordation of the federal tax liens, even though made pursuant to an authorized provision of a prior recorded mortgage, must be subordinated to the federal tax lien because such lien so acquired by the mortgagee was unperfected and inchoate at the time the federal tax liens were recorded.

For the same reasons, we must subordinate to priority of the federal tax liens the claim for an attorney fee paid by Perpetual in protection of the lien of its mortgage. The fee was incurred long after the attachment of the federal tax lien; and at the time of the execution of the mortgage and the creation of the debt secured thereby, the future existence or amount of such attorney fee was, at best, speculative and uncertain.

As to Perpetual's claim to reimbursement for its payment of an attorney fee, we are cited to United States v. Seaboard Citizens Nat'l Bank, 206 F.2d 62 (4th Cir. 1953). Therein, an automobile that was subject to a mortgage was seized and forfeited by the United States for violation of the Internal Revenue laws (liquor). The mortgagee filed its petition for remission of the forfeiture to the extent of its mortgage interest pursuant to the provisions of 18 U.S.C.A. § 3617.[6] The District Court granted such petition and allowed, as a part of the secured mortgage debt, a fifteen per cent attorneys fee, provision for which was specifically made in the default provision of the mortgage. This court affirmed the District Court stating that: "The contingent liability for attorneys fees having become absolute, there was no reason why the remission should not extend to this as well as to other parts of the obligation secured." Earlier in the opinion, the court considered and accepted as authority Security Mortgage Co. v. Powers, 278 U.S. 149, 49 S.Ct. 86 (1928). In neither Seaboard nor

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[6] "§ 3617. Remission or mitigation of forfeitures under liquor laws; possession pending trial—(a) jurisdiction of court

"Whenever, in any proceeding in court for the forfeiture, under the internal-revenue laws, of any vehicle or aircraft seized for a violation of the internal-revenue laws relating to liquors, such forfeiture is decreed, the court shall have exclusive jurisdiction to remit or mitigate the forfeiture.

"(b) * * * * *

"(c) * * * * *

"(d) * * * * *".

Security Mortgage v. Powers was a lien for delinquent federal taxes involved. The opinion in Seaboard does not disclose whether default in the payment of the mortgage occurred prior or subsequent to seizure and forfeiture of the mortgaged property.

In Seaboard it was stated:

> "The argument that the government will be burdened by allowing such fees to be included in the lien as to which remission is granted is without foundation. The government does not pay the fees. They are paid out of the proceeds of the property condemned. * * *"

In the instant case, the amount derived from the sale of the property was far from sufficient to pay the mortgagee's principal debt, interest, unpaid and delinquent real estate taxes, an attorney fee and the Government's claim for unpaid taxes as represented by its recorded liens. The amount to be received by the Government from the proceeds of sale is correspondingly reduced by all prior payments from the available fund, and thus the direction of payment of an attorney fee prior to payment of federal taxes is the equivalent of a direction to pay such fee out of the federal treasury. In the Seaboard case; any amount received by the United States from sale of seized property was unanticipated revenue, a windfall, not to be credited as a payment on a fixed indebtedness.

It is important to note the legislative purpose in enacting the statutes involved in the case at bar and in the Seaboard case. As was indicated in United States v. Security Trust & Sav. Bank, supra, the purpose of the federal tax lien statute is to insure prompt and certain collection of taxes due the United States from tax delinquents. The courts have consistently held that the property of a delinquent taxpayer must be first applied to the satisfaction of the claims for

federal taxes except in the specific instances listed in § 6323(a). On the other hand, the plain intention of the Congress in enacting laws providing for seizure, forfeiture and disposition of property used in violation of the Internal Revenue laws, particularly 18 U.S.C.A. §§ 3615 and 3616, was not to secure to the United States any claim for indebtedness already determined, but was to exact a penalty for violating the law. Therefore, the zealous protection of the revenues of the United States would not appear to be of paramount importance in the enactment of the seizure and forfeiture statutes as in the enactment of the federal tax lien laws. Section 3617 of 18 U.S.C.A. prevents the forfeiture claim of the United States from being absolute and provides that the court may decree remission of the forfeited vehicle if, upon proof of good faith, it is satisfied that an innocent creditor would otherwise be deprived of his right to security. Since no strict test has been evolved under this statute to determine the extent of the security of the mortgage as against the forfeiture claimant, this court, in the Seaboard case, gave effect to the Virginia law which allowed an attorney fee as a part of the secured interest. But, from the cases hereinbefore cited, we find the federal courts refusing, in cases involving a determination of priority of federal tax liens, to accept the characterization and classification, by state courts, of liens created and asserted under state law. Here, we are governed by the well established principles laid down by the Supreme Court in cases determining priorities of federal tax liens under §§ 6321, 6322 and 6323 of 26 U.S.C.A. wherein the court has assiduously protected the tax claims of the government. Although our decision under the facts and circumstances of the instant case cannot be construed as overruling United States v. Seaboard Citizens Nat'l Bank, supra, we cannot here accept the case as supporting Perpetual's claim to allowance of a reasonable attorney fee prior to the tax liens of the United States.

Accordingly, judgment of the District Court will be reversed and the case remanded for further proceedings consistent with the views herein expressed.

Reversed and remanded.

HAYNSWORTH, Circuit Judge, dissenting:

There are implications in the decisions of the Supreme Court which support the view of my brothers, but I find in those decisions no clear command which governs us here. Since we enter upon a new, judicially-untilled field over which Congress has exercised its right of control, it seems appropriate to consider the meaning of the statute which directs us to prefer prior mortgagees to the United States claiming under a tax lien.[1] If the question be not foreclosed by decisions of the Supreme Court, and I think it is not, we should not transplant rules developed for the classification of interests which enjoy no statutory preference into a new field to restrict recognition of the preference of interests that do, unless of course, there is reason to attribute to Congress an intention that the preferred and unpreferred interests should be classified under the same rules in order to determine their standing in relation to the tax lien.

When the Supreme Court adopted the rule of "the first in time is the first in right"[2] for the purpose of classifying liens competing, without the benefit of a statutory preference, with the tax lien, substantial qualification was essential if the tax lien was not to be emasculated. Among the many liens and priorities recognized by the laws of the states, most were far from the standing of those interests which Congress had selected for preferential treatment. Without substantial qualification of a simple rule of prior-

[1] 26 USCA § 6323(a)

[2] United States v. City of New Britain, 347 U.S. 81, 74 S.Ct. 367, 98 L.Ed. 520.

ity in time and a reserved right of federal classification, such interests, created and controlled by the states, would threaten frustration of the tax lien.

A state's provisional remedies may provide a number of interlocutory liens, but the possessor of such a lien need not be classified with the judgment creditor whom the statute prefers. The litigant who commences his action by attachment entertains some hope of becoming a judgment creditor, but he may encounter many a pitfall along the way. As a judgment creditor, he is in the embryonic stage. His attachment may be perfected in itself, but, viewed as a first step toward ascent to the preferential status of a judgment creditor, it is neither perfected nor completed.

The Supreme Court might have said, as Mr. Justice Jackson did say,[3] that all interests should be deferred to the tax lien save only those which Congress chose to prefer. Resort to the inchoate test, applied to the competing lien,[4] approached the same result. At least, it avoided the necessity of treating the lien products of a state's provisional remedies as judgments.[5]

In a series of cases,[6] the Supreme Court held that

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[3] United States v. Security Trust & Sav. Bank, 340 U.S. 47, 71 S.Ct. 111, 95 L.Ed. 53.

[4] The test seems never to have been directed to the tax lien. Here the tax lien was recorded when the taxpayer's substantive tax liabilities were being litigated in this Court. See Bond v. Commissioner, 4 Cir., 232 F.2d 822. It may issue upon a jeopardy assessment long before a determination of the substantive tax liability. 26 USCA § 6861.

[5] United States v. Security Trust & Sav. Bank, 340 U.S. 47, 71 S.Ct. 111, 95 L.Ed. 53; United States v. Aeri, 348 U.S. 211, 75 S.Ct. 239, 99 L.Ed. 264; United States v. Liverpool & London & Globe Insurance Co., Ltd., 348 U.S. 215, 75 S.Ct. 247, 99 L.Ed.268; United States v. Scovil, 348 U.S. 218, 75 S.Ct. 244, 99 L.Ed. 271.

[6] United States v. Colotta, 350 U.S. 808, 76 S.Ct. 89, 100 L.Ed. 725; United States v. White Bear Brewing Co., 350 U.S. 1010, 76 S.Ct. 646, 100 L.Ed. 871; United States v. Vorreiter, 355 U.S. 15, 78 S.Ct. 19, 2 L.Ed.2d 23.

antecedent mechanic's liens, which are supported by no statutory preference, were deferred to the tax lien. We may infer that a majority of that Court regarded the mechanic's liens as inchoate within the meaning of the rule developed for the classification of deferred interests. It is difficult to understand how a mechanic's lien, duly filed and recorded and presently in the process of being foreclosed, a specific lien against specific property for a specific amount, may be said to be inchoate, unless it is viewed as an interim step in the lienor's progress toward the status of a judgment creditor and the foreclosure of all possible defenses to his claim. Such a view may not be inappropriate, however, in light of the fact that Congress has selected certain interests for preferential treatment, among them those of a judgment creditor, not those of a mechanic's lienor.[7] In such a view, there is apparent analogy between the mechanic's lien and the lien product of provisional remedies.[8]

As suggested, this is a different question. Its answer perhaps should come from the Congress. In any event, the mechanic's lien cases in no way suggest that the rule applied in the classification of deferred interests should be employed to classify preferred interests. In only two cases in the Supreme Court is there any intimation that the inchoate test has any place in the classification of preferred interests.

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[7] In this sense, the tax lien would appear to be always inchoate. It is not self-enforcing. It protects and fixes the property rights of the United States, but is enforceable by a civil action. See 26 USCA § 7403.

[8] What is most troublesome about the mechanic's lien cases is really a different question: Whether Congress ever intended the tax lien to appropriate, without compensation, the property and interests of others than the taxpayer, others who have no legal or moral obligation to pay the tax debt. When the tax lien seizes property, the real value of which has been largely enhanced by the lienor's labor and materials, it appropriates values which the mechanic had created and which are his, in an economic sense, until he is compensated and his lien or right to a lien is discharged. The seizure of such values seems an unjust enrichment of the United States at the expense of the mechanic, not that of the taxpayer.

In New Britain,[9] the immediate conflict was between the tax lien and a municipality's liens for ad valorem taxes and water rents. There was no statutory basis for preferment of the municipality's claims, but the Supreme Court held those which were fully accrued when the tax lien attached should be preferred while those which were not then accrued were inchoate and should be deferred. In its rule of distribution, however, funds allocable to a mortgage debt were directed to be applied first to those claims of the municipality which were deferred to the tax lien but, under state law, preferred to the mortgage lien. The result of the rule of distribution was a recognition of the preference of the mortgage lien, but only secondarily for the benefit of the mortgagee, to whom the statutory preference is granted, and primarily for the benefit of a lienor having no statutory claim to preferment.

If it may be said that New Britain's rule of distribution withholds full recognition of the mortgagee's statutory preference, there is no answer to the problem which would not be open to similar criticism. If the claims for accruing taxes and water rents had been subordinated to the mortgage debt, they would have been deprived of recognition of the priority to which they were entitled under state law. If they had been preferred over the tax lien, the tax lien would have been denied the priority which the Supreme Court had held it to have. There was inconsistency in the relative priorities of the multiple claims which no rule of distribution could eliminate.

That the Supreme Court made the choice it did, under those circumstances, does not lead to the conclusion that, under other circumstances, in which there is no necessity for arbitrary selection, it would narrowly construe the congressional command or restrict it by the importation of

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[9] United States v. New Britain, 347 U.S. 81, 74 S.Ct. 367, 98 L.Ed. 520.

judicially developed rules for the classification of unpreferred interests.

In New Britain, reference was made to the situation with which we now deal, but decision upon it was expressly reserved. The reservation, in light of the dissimilarity of the problem in New Britain, leads to the conclusion that the decision in New Britain no way settles the question here.

In Ball Construction Company,[10] it is clear that the lower courts [11] and the four dissenters regarded the assignment, as collateral security for the payment of future indebtedness, of the account receivable as tantamount to a mortgage and were of the opinion that the assignee should be treated as a mortgagee within the meaning of the preference statute. I understand my brothers to attribute the same opinion to the majority and to construe Ball Construction as a holding that a mortgagee is not entitled to the preferential treatment the statute commands to the extent the mortgage debt is inchoate when the tax lien is recorded.

Theirs is a not unreasonable interpretation of the brief per curiam opinion. A different interpretation, however, seems equally reasonable and more likely. The very fact that the views of the majority were unelaborated in their summary disposition of the issue suggests an absence of an intention to effect a novel extension of a particular rule devised to meet dissimilar conditions. One would suppose that, had the majority intended to decide an important question never before considered by the Supreme Court, it would have stated the considerations which led to its resolution of the issue.

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[10] United States v. Ball Construction Co., 355 U.S. 587, 78 S.Ct. 442, 2 L.Ed. 2d 510.

[11] Ball Construction Company v. Jacobs, D.C.W.D. Texas, 140 F.Supp. 60, aff'd. sub nom. United States v. Ball Construction Company, 5 Cir., 239 F. 2d 384.

It seems more likely than not that the majority in Ball Construction were of the opinion that the assignee was not a mortgagee within the meaning of the statute. While it was contended that, under the laws of Texas, the assignee was a mortgagee, a similar contention had been rejected in Gilbert Associates.[12] There, the Town had contended that its liens, under the law of New Hampshire, gave it the status of a judgment creditor. The court held, however, that the words of the statute should be given their ordinary, common-law meaning. It concluded that one who held no judgment was not a judgment creditor, within the meaning of the statute, though, under state law, he had the rights of one. So, the majority in Ball Construction may well have been of the opinion that an assignee, as collateral security, of an account receivable is not a mortgagee within the meaning of the statute, though, under state law, the assignee has the rights of a mortgagee.

The majority in Ball Construction did not characterize the assignment as a mortgage. It simply said that the "instrument" being inchoate, the statute preferring specific claimants did not apply.

This is consistent with the entire course of decision in the Supreme Court. Attachment liens, mechanic's liens and other liens, in themselves perfected and complete, had consistently been characterized as inchoate because they had not matured into judgments, and, therefore, had not been brought within the protection of a statute granting a preference to judgment creditors. If the conditional assignee of a receivable is not a "mortgagee" within the ordinary, common-law meaning of that word, he held a security interest which might have ripened into a judgment. In this view, it was appropriate for the majority to say that the unripened interest was inchoate and beyond the protection of a statute preferring judgment creditors.

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[12] United States v. Gilbert Associates, Inc., 345 U.S. 361, 73 S.Ct. 701, 97 L.Ed. 1071.

The supporting citations[13] have nothing to do with the question whether rules devised for the classification of congressionally unpreferred interests should be applied to defer congressionally preferred interests. Each of the two cited cases dealt with congressionally unpreferred interests. Their citation suggests the majority thought the interest of the assignee comparable to that of the attaching creditor and the municipal lienor, whose only claim to statutory preferment was that their interests, in the future, might ripen into judgments.

If the decision in Ball Construction has not foreclosed the present question, and it seems to me far from certain that it has, it is incumbent upon us to focus our attention upon the statute which confers a preference upon a "mortgagee" and to inquire whether the statute should be so construed as to withhold preferential treatment from one, indisputably a mortgagee, to the extent the mortgage debt is uncertain in amount or not fully accrued when the tax lien is recorded.

This, the crucial question, need not detain us long. If our view of the statute be not obscured by rules developed for the deferment of unpreferred interests, it seems clear that the words of the statute were used in their "usual, conventional sense."[14] The Congress did not prefer the principal of the mortgage debt; it preferred the mortgagee. If the word is to be given its usual meaning the preference cannot be limited to the mortgagee's right to repayment of the principal of the mortgage debt. It extends to all those rights which the Congress must have known the mortgagee commonly and usually possesses.

Provisions in mortgages requiring or permitting the mortgagee to discharge ad valorem tax liens and extending

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[13] United States v. Security Trust & Sav. Bank, 340 U.S. 47, 71 S.Ct. 111, 95 L.Ed. 53; United States v. City of New Britain, 347 U.S. 81, 74 S.Ct. 367, 98 L.Ed. 520.

[14] United States v. Gilbert Associates, Inc., 345 U.S. 361, 73 S.Ct. 701, 97 L.Ed. 1071.

the mortgage lien to such disbursements, as well as to the expense of enforcement of the mortgagee's rights, are commonplace. There is nothing novel in recognition of the fact that the protection of the mortgage lien extends to such disbursements and expenses, made pursuant to such provisions, as fully as to the principal of the mortgage debt itself. It is a usual and conventional right of a mortgagee. When Congress created the preference, such rights of the mortgagee were generally recognized in commerce and in law. If we are to give the language of the statute its usual and ordinary meaning, we cannot deny to the mortgagee his usual and ordinary rights. Since the statute confers the preference upon the mortgagee, it seems to require us to recognize the preference, at the least, to the extent that his preference has been traditionally and commonly recognized in the state courts. I see no reason to suppose that Congress intended the preference it commanded to differ in kind and quality from the preference the selected classes have enjoyed historically and, in commercial circles, are generally thought to have.

While the question is novel in this court, and, I believe, open in the Supreme Court, there are analogies that bear mention.

A mortgagee's collection out of the security of attorney's fees incurred after the mortgagor's adjudication in bankruptcy was resisted upon the ground that the claim was contingent at the time of adjudication and, therefore, not provable. The Supreme Court held there was no need to prove the claim for the right to attorney's fees was fully protected by the mortgage lien from the time that lien first attached.[15] In the opinion it was said, "The lien was not inchoate at the time of the adjudication."

This Court dealt with a similar problem when attorney's fees were incurred by a mortgagee after forfeiture of the

[15] Security Mortgage Co. v. Powers, 278 U.S. 149, 49 S.Ct. 83, 73 L.Ed. 236.

mortgaged vehicle to the United States.[16] We held the right to attorney's fees fully protected from the date the mortgage lien attached, saying, "The lien for attorney's fees was not inchoate at the time of the offense."

As the rules have been developed in the tax lien cases, the claim for attorney's fees was inchoate when the tax lien attached. Perhaps we may say as the Supreme Court said in the bankruptcy case that the lien which supports the claim was not inchoate. Whether we do or not, we should reach a similar result here, for no valid reason appears for reading limitations into the preference statute which the language of the statute does not contemplate.

The specific question has arisen in other courts.

The mortgagee has been held preferred with respect to attorney's fees and similar expenses incurred after the tax lien was recorded,[17] and with respect to state taxes paid by the mortgagee.[18] The mortgagee's preference with re-

[16] United States v. Seaboard Citizens Nat. Bank of Norfolk, 4 Cir., 206 F. 2d 62.

[17] United States v. Halton Tractor Company, 9 Cir., 258 F.2d 612; United States v. Sampsell, 9 Cir., 153 F.2d 731; Smith v. United States, D.C. Hawaii, 113 F. Supp. 702; Bank of America Nat. Trust & Savings Ass'n. v. United States, D.C.S.D. Cal., 84 F. Supp. 387; Ormsbee v. United States, S.D. Fla., 23 F.2d 926; cf. In Re New Haven Clock & Watch Company, 2 Cir., 253 F.2d 577, in which the inchoate test was used to deny priority for a similar disbursement.

[18] United States v. Miller, D.C.S.D. Fla., 55-1 USTC, par. 9484; cf. United States v. Christensen, 9 Cir., 269 F.2d 624 and United States v. Lord, D.C.N.H., 155 F. Supp. 105. The result in Christensen, preferring the tax lien to the extent the mortgage secured disbursements for state taxes, was reached on the basis of a generalized notion of federal supremacy. Such a notion seems out of place when Congress, itself, has decided to prefer the mortgagee over the United States claiming under its tax lien.

See also, Peoples Bank v. United States, D.C.N.D. Ga., 98 F. Supp. 874, extending the priority of the mortgagee to subsequent advances under an open-end mortgage, reversed upon the ground that the subsequent advance was a separate transaction unsecured by the lien of the first mortgage. United States v. Peoples Bank, 5 Cir., 197 F.2d 898.

spect to accruing interest has been generally recognized.[19] Perhaps the right to interest accruing at an agreed rate could pass the inchoate test, but to a substantive recognition of the mortgagee's preference, his right to be secure in his income is hardly so important as his right to be secure in making disbursements necessary for the protection or preservation of the mortgage lien and for the collection of the principal of the mortgage debt.

Believing, as I do, that the statute should govern our decision and that it requires a recognition of the preference the mortgagee has enjoyed generally and historically, I would affirm.

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[19] United States v. Halton Tractor Company, 9 Cir., 258 F.2d 612; Jefferson Standard Life Insurance Company v. United States, 9 Cir., 247 F.2d 777; United States v. Sampsell, 9 Cir., 153 F.2d 731; Glenn v. American Surety Co., 6 Cir., 160 F.2d 977; United States v. Lord, D.C.N.H., 155 F. Supp. 105; Bank of America Nat. Trust & Savings Ass'n. v. United States, D.C.S.D. Cal., 84 F. Supp. 387; Ormsbee v. United States, S.D. Fla., 23 F.2d 926.

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No. 362

In the Supreme Court of the United States

OCTOBER TERM, 1960

V. F. BOND, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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Solicitor General,

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Revised Statutes, Sec. 3466 (31 U.S.C. 1958 ed., Sec. 191)	2, 11

In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 362

V. F. BOND, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The memorandum of the District Court in relation to reimbursement of the mortgagee for real estate taxes (Pet. 1a-6a) is reported at 172 F. Supp. 759. The memorandum of the District Court dealing with the mortgagee's claim for attorney's fees (Pet. 6a-7a) is not officially reported. The opinions of the Court of Appeals (Pet. 8a-36a) are not yet officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on May 31, 1960. (R. 104.) The petition for a writ of certiorari was filed on August 25, 1960. Jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

1. Whether the priority of a mortgage over a subsequent federal tax lien extends to local real estate taxes accruing and paid by the mortgagee after the effective date of the federal tax lien.

2. Whether the priority of a mortgage over a subsequent federal tax lien extends to attorney's fees incurred by the mortgagee after the date of the federal tax lien in contesting the priority of the federal tax lien over the mortgagee's claim for reimbursement of local real estate taxes.

STATUTES INVOLVED

The statutes involved, Sections 6321, 6322 and 6323(a) and (b) of the Internal Revenue Code of 1954, and Section 3466 of the Revised Statutes, are set forth in the Appendix, *infra*, pp. 10-12.

STATEMENT

The relevant facts are not in dispute, and are summarized in the opinion of the Court of Appeals (Pet. 9a-11a) as follows:

On December 20, 1955, deficiencies were assessed against the taxpayers for the years 1943 through 1947, totaling $318,832.84, and on the same day deficiencies were assessed against taxpayer, V. F. Bond, for the year 1942 in the amount of something over $18,000. On or about December 20, 1955, notices of such assessments were served upon the taxpayers and demand for payment was made, but taxpayers refused to pay.

On December 21, 1955, notice of lien for each assessment was recorded in the proper county and municipal offices pursuant to the Internal Revenue Code of 1954, Section 6323(a)(1). On July 2, 1957, the assessments had been reduced to judgment.

The complaint filed in this action for foreclosure of the tax liens listed various properties owned by the taxpayers, among them the Arlington Hotel, at Arlington, Virginia, the property involved in this controversy. The United States requested the appointment of a Receiver to take charge of, marshal and liquidate the properties, and prayed *inter alia* that the court determine the validity and priority of all liens and claims and order a foreclosure of the liens of the United States and a sale of the properties.

On November 27, 1957, the District Court found that the United States had valid liens in the principal sum of $357,484.18, plus interest, for the years involved, and that the taxpayers were insolvent. The court then appointed a Custodial Receiver to take charge of the properties of the taxpayers and appointed a Special Master to ascertain and report to

the court the claims against the taxpayers, the value of their properties and the validity and priority of liens on such properties. Pursuant to the recommendations of the Receiver, the Arlington Hotel property was sold for $172,500.

The Arlington Hotel property was subject to a mortgage, executed by taxpayers as mortgagors, securing a loan in the original principal sum of $100,000 made by Perpetual Building Association. This mortgage was recorded on July 15, 1955, some six months prior to the recordation of the notice of federal tax lien. Monthly payments were made by the mortgagors until October 4, 1956, after which no further payments were received by Perpetual.

Under the mortgage each monthly payment was allocated not only to the payment of principal and interest, but a portion, $331, was also set aside in a fund for the payment of taxes accruing against the mortgaged property. The mortgage contained other provisions as follows:

> *It Is Hereby Covenanted*: * * * (2) that any and all taxes and assessments, general or special, now or hereafter assessed against said realty shall be paid when due, * * * (7) that the title to said realty and the record of said title shall be kept free of litigation, infirmity and lien, * * * (10) that any and all disbursements made by the Treasurer [of Perpetual] because of the failure of the grantor to make any payment or do any act required to be made or done, with interest thereon at six percent (6%) per annum, shall be demandable at any time by the Treasurer and, until repaid to the Treasurer, shall be

> deemed to be secured by this Deed of Trust, and (11) that if there shall be any default in the performance of any of the foregoing covenants the Treasurer shall have the right and power to do any one or more of the following: (a) do any act or make any disbursement, in his name or the name of the grantor, which he may deem necessary or proper to protect the lien of this Deed of Trust, * * *.

After default by the mortgagors, Perpetual paid the local real estate taxes assessed for the years 1957 and 1958, which had accrued and had been assessed subsequent to the recordation of the notice of federal tax liens. While a portion of the payment made for 1957 taxes came from the accumulated fund paid and held for this purpose, Perpetual paid from its own funds on August 16, 1957, $4,759.16 for the year 1957 and on August 11, 1958, $4,787.16 for the year 1958. Perpetual claims that it has a lien for those amounts, with interest, by virtue of the provision of the mortgage, and that such lien is prior to the federal tax liens.

The District Court held (Pet. 1a-6a) that Perpetual was entitled to be reimbursed for the real estate taxes before satisfaction of the lien for federal taxes. In a separate unreported memorandum opinion, the court allowed an attorney's fee of $1,000, payable to Perpetual from the proceeds of sale as a cost of liquidating the mortgage, this also to take priority over the federal tax liens. (Pet. 6a-7a.) The Court of Appeals (one judge dissenting) reversed the District Court both as to the real estate taxes and as to the attorney's fee. (Pet. 8a-36a.)

ARGUMENT

These propositions are clear: A lien of the United States for taxes is subordinate to a mortgage lien which is first in point of time; by the same token, the lien of the United States takes precedence over the security interest of a mortgagee arising *subsequent* to the date that the federal lien is perfected. As Section 6323 of the Internal Revenue Code (*infra*, p. 10) declares, the federal tax lien is valid "as against any mortgagee, pledgee, purchaser or judgment creditor" as soon as the requisite notice is filed.

In the instant case, notice of the federal lien was filed in December of 1955. Thereafter, the mortgagee paid local real estate taxes (for the years 1957 and 1958) owed by the United States' debtor (the mortgagor). The sum represented by these payments obviously could not have been a part of the mortgage debt when the federal lien attached. The mortgagee meets this with the assertion that under the contract of mortgage the mortgagee was empowered to pay local real property taxes in order to protect its underlying security. This, however, does not detract from the conclusion that payment of the local taxes by the mortgagee created a new and additional monetary obligation as between mortgagor and mortgagee and that this obligation (as well as the lien to which it gave rise) was junior in point of time to the secured claim of the United States for taxes.[1]

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[1] Note that the municipality's lien for these taxes would itself be inferior to the prior tax lien of the United States. *United States* v. *New Britain*, 347 U. S. 81. Accordingly, as

The mortgagee's contention is essentially one of "relation back." But the fact that the mortgagee had the power, under an earlier instrument, to add to the mortgage debt, does not alter the situation. The crucial date is the date that the power was exercised. In a long line of decisions[2] (which are reviewed in the opinion below, Pet. 14a-22a), this Court has made it unmistakably plain that it will not apply doctrines of "relation back," and that a competing lien asserted against the United States must be (1) prior in point of time and (2) choate.[3] As the Court of Appeals stated (Pet. 22a), this Court has applied the choate-lien test "first in insolvency cases, then in statutory lien cases, and finally in non-statutory contractual lien cases." Since this prin-

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pointed out in *United States* v. *Wasserman*, 257 F. 2d 491, 494-495 (C. A. 1st), the mortgagee's act does not benefit the United States or protect its security interest.

[2] See *United States* v. *Security Tr. & Sav. Bk.*, 340 U. S. 47; *United States* v. *New Britain*, 347 U. S. 81; *United States* v. *Acri*, 348 U. S. 211; *United States* v. *Liverpool & London Ins. Co.*, 348 U. S. 215; *United States* v. *Scovil*, 348 U. S. 218; *United States* v. *Colotta*, 350 U. S. 808; *United States* v. *White Bear Brewing Co.*, 350 U. S. 1010; *United States* v. *Vorreiter*, 355 U. S. 15; *United States* v. *Ball Construction Co.*, 355 U. S. 587; *United States* v. *Hulley*, 358 U. S. 66.

[3] *Aquilino* v. *United States*, 363 U. S. 509, and *United States* v. *Durham Lumber Co.*, 363 U. S. 522, decided last Term, cite with approval this Court's earlier decisions concerning "the priority of competing liens asserted against the taxpayer's 'property' ", 363 U. S. at 514. *Aquilino* and *Durham* turn on the question whether the respective taxpayers had property interests in the funds to which the Federal Government had laid claim.

ciple of priority is firmly settled by decisions of this Court, and since the only other Court of Appeals' decision which deals with the precise factual situation presented here (*United States* v. *Christensen*, 269 F. 2d 624 (C. A. 9th)) is in full accord with the decision below,[4] there is no occasion for further review.

The mortgagee has also advanced a claim for an attorney's fee, incurred long after the attachment of the federal tax lien, paid for the attorney's services in seeking to establish the priority of the mortgagee's claim for reimbursement of local real estate taxes.[5] Obviously, this claim cannot rise higher than the principal claim to which it is ancillary.[6]

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[4] The decision of the Supreme Court of Wisconsin in *First National Bank of Chippewa Falls* v. *Charles Henneman Co.*, 10 Wis. 2d 260, petition for certiorari pending, No. 283, this Term, is also entirely consistent with the decision below. Such disagreement as persists is in lower state courts. See the Government's brief in opposition in No. 283, pages 6-7.

[5] This fee is discrete from the fees incurred in connection with the receivership and sale of the property, which were allowed without objection by the United States.

[6] Because of the failure of the United States to present the point in the District Court, the court below did not rely upon R.S. 3466 (*infra*, pp. 11-12), which in terms grants priority to the United States when the debtor is insolvent.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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SEPTEMBER 1960.

APPENDIX

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1958 ed., Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1958 ed., Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia.*—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) *Form of Notice.*—If the notice filed pursuant to subsection (a)(1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) *Exception in Case of Securities.*—

* * * *

(26 U.S.C. 1958 ed., Sec. 6323.)

Revised Statutes:

SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the

estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

(31 U.S.C. 1958 ed., Sec. 191.)

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